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TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, ~~1929~~ 1930

No. ~~198~~ 7

THE ALUMINUM CASTINGS COMPANY,
PETITIONER,

vs.

CARL F. ROUTZAHN, INDIVIDUALLY AND AS
COLLECTOR OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT
COURT OF APPEALS FOR THE SIXTH CIRCUIT

PETITION FOR CERTIORARI FILED JUNE 26, 1929

CERTIORARI GRANTED OCTOBER 21, 1929

(34,329)

(34,329)

SUPREME COURT OF THE UNITED STATES

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ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

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[fol. 1] [Caption omitted]

[fol. 2]

IN UNITED STATES DISTRICT COURT, NORTHERN DISTRICT OF OHIO

AMENDED PETITION

Filed Nov. 10, 1926

Now comes the plaintiff, The Aluminum Castings Company, and complaining of the defendant, Carl F. Routzahn, says:

That this plaintiff is and was at all times hereinafter mentioned a corporation duly organized and existing under and by virtue of the laws of the State of Ohio, with its principal office and place of business located in the City of Cleveland in said state, and a citizen of said state and a resident of the Eastern Division of the Northern District thereof; that the defendant, Carl F. Routzahn, is and for some years past has been the Collector of Internal Revenue for the Eighteenth District of Ohio; that the defendant, Carl F. Routzahn, is a resident of the Eastern Division of the Northern District of Ohio; and that this action arises under a law of the United States providing for internal revenue;

That in the year 1916 the plaintiff made articles from which it derived a profit which was held to be subject to the tax imposed by Title III of the Revenue Act of 1916 and known as the munitions manufacturers' tax; that the so-called munitions manufacturers' tax of the plaintiff imposed on profits made on munitions manufactured and sold in the year 1916 in the sum of Two Hundred and Forty-six Thousand Two Hundred and Seventy-five Dollars and sixty-three cents ($246,275.63) was paid to the United States Government by this plaintiff in the year 1917; that in its federal income tax return for the year 1916 this plaintiff did not deduct from its gross income its said munitions manufacturers' tax of Two Hundred and Forty-six Thousand Two Hundred and Seventy-five Dollars and

sixty-three cents ($246,275.63) because not paid during said year; that having paid said munitions manufacturers' tax in the year 1917 the plaintiff in its federal income and profits tax returns filed with the United States Internal Revenue Department for the said year 1917 deducted the said munitions manufacturers' tax from its gross income, said deduction being made pursuant to the provisions of the Revenue Act of 1916, Title I, Section 12 (a), as amended October 3, 1917; that the plaintiff filed its federal income tax return for each of the years 1916 and 1917 (including its so-called profits tax return [fol. 3] for 1917), as it had previously done for the years 1913, 1914 and 1915, on an actual receipt and disbursement basis, treating its ordinary accounts and bills receivable and payable necessarily arising by reason of the operation of its manufacturing busines as actual receipts and disbursements on the dates on which they were entered on its books, and in its federal income tax returns for the years 1916 and 1917 the plaintiff, in reply to the question on the income tax blanks as to whether or not the return was made on the basis of actual receipts and disbursements, explicitly stated that it was, it being added on the 1917 return that bills and accounts receivable and payable are treated as actual receipts and disbursements; that the income tax returns of this plaintiff for the years 1913 to 1917, both inclusive, (including the plaintiff's profits tax return for 1917), were audited and adjusted and approved by the Internal Revenue Department as actual receipt and disbursement returns in every particular except as to the munitions manufacturers' tax; that in making its federal income tax returns for the years 1916 and 1917, as well as for previous years, the plaintiff reported its taxes on an actual receipt and disbursement basis, and pursuant to the receipt and disbursement method of reporting income, the plaintiff deducted the munitions manufacturers' tax of Two Hundred and Forty-six Thousand Two Hundred and Seventy-five Dollars and sixty-three cents ($246,275.63) paid by it in 1917 from its gross income for that year; that the munitions manufacturers' taxes of the plaintiff were never accrued on its books nor were any reserves ever set up against its munitions manufacturers' taxes, its munitions manufacturers' taxes being entered on

the books of the plaintiff on the actual disbursement basis; and that the plaintiff never elected to avail itself of the privilege granted by Section 13 (d) of Title I of the Revenue Act of 1916 to make its income and profits tax returns upon an accrual basis, or otherwise to avail itself of any privilege conferred by said Section;

That the Commissioner of Internal Revenue erroneously and illegally disallowed the said munitions manufacturers' tax of Two Hundred and Forty-six Thousand Two Hundred and Seventy-five Dollars and sixty-three cents ($246,275.63), paid by the plaintiff in the year 1917, as a deduction from the gross income of the plaintiff for the year [fol. 4] 1917, and transferred it back as a deduction from the gross income of the plaintiff for the year 1916 in figuring the income and profits taxes of the plaintiff for said years, and also erroneously and illegally deducted the amount of said munitions manufacturers' tax from the invested capital of the plaintiff for the year 1917; that by reason of the said transfer of the munitions manufacturers' tax deduction from the year 1917 to the year 1916 and the said decrease in this plaintiff's invested capital for the year 1917, the federal income and profits taxes of the plaintiff were increased for the year 1917 in the sum of One Hundred Seventy-nine Thousand Nine Hundred Seventy-eight Dollars and eighty-six cents ($179,978.86), and decreased for the year 1916 in the sum of Four Thousand and Nine Hundred and Twenty-five Dollars and fifty-one cents ($4,925.51), making a net increase of One Hundred Seventy-five Thousand Fifty-three Dollars and thirty-five cents ($175,053.35) in said federal income and profits taxes for the years 1916 and 1917 on account of the said transfer of said munitions manufacturers' tax deduction from the year 1917 to the year 1916 and said decrease in invested capital, which sum was erroneously and illegally assessed against the plaintiff;

That during the year 1919 the plaintiff paid to Harry H. Weiss, then Collector of Internal Revenue for the Eighteenth District of Ohio, as federal income and profits taxes for the year 1918, the sum of Thirty-four Thousand Seven Hundred and Thirty-nine Dollars and six cents ($34,739.06); that the net income of the plaintiff for the year 1918 amounted to Three Hundred Fifteen Thousand

and Thirty-three Dollars and fifty-one cents ($315,033.51); that in the year 1919 the plaintiff sustained a net loss from the operation of the business regularly carried on by it of One Million Four Thousand One Hundred and Thirteen Dollars and eighty-nine cents ($1,004,113.89); that by reason thereof the plaintiff was entitled to have refunded to it the said sum of Thirty-four Thousand Seven Hundred and Thirty-nine Dollars and six cents ($34,739.06), paid by it as federal income and profits taxes for the year 1918; that the plaintiff duly filed with the Commissioner of Internal Revenue a claim for refund of said sum of Thirty-four Thousand Seven Hundred and Thirty-nine Dollars and six cents ($34,739.06), and said claim was decided to be valid by said Commissioner of Internal Revenue, but said sum of Thirty-four Thousand Seven Hundred [fol. 5] and Thirty-nine Dollars and six cents ($34,739.06), instead of being refunded to the plaintiff, was credited by the United States Government, Eight Thousand Fifty Dollars and sixteen cents ($8,050.16) against certain miscellaneous additions to the federal income and profits taxes of this plaintiff for the years 1916 and 1917, and Twenty-six Thousand Six Hundred and Eighty-eight Dollars and ninety cents ($26,688.90) against the aforesaid wrongful and illegal additional assessment of income and profits taxes in the sum of One Hundred Seventy-five Thousand and Fifty-three Dollars and thirty-five cents ($175,053.35) made against the plaintiff for the years 1916 and 1917, on account of the said transfer of the said munitions manufacturers' tax from the year 1917 to the year 1916, and the said decrease of invested capital, leaving a balance of said erroneous and illegal assessment of One Hundred Forty-eight Thousand Three Hundred and Sixty-four Dollars and forty-five cents ($148,364.45);

That thereafter Carl F. Routzahn, then Collector of Internal Revenue for the Eighteenth District of Ohio, notified the plaintiff that unless said sum of One Hundred Forty-eight Thousand Three Hundred and Sixty-four Dollars and forty-five cents ($148,364.45) and interest thereon amounting to Eighteen Thousand Five Hundred and Forty-five Dollars and fifty-six cents ($18,545.56), or a total of One Hundred Sixty-six Thousand Nine Hundred and Ten Dollars and one cent ($166,910.01), was paid

to him on or before July 14, 1923, penalties would be inflicted upon the plaintiff and the property of the plaintiff distrained and sold; that thereupon, to-wit, on July 14, 1923, the plaintiff, although maintaining that the collection of said sum of One Hundred Sixty-six Thousand Nine Hundred and Ten Dollars and one cent ($166,910.01) was illegal, but in order to avoid the distraint and the sale of its property and the imposition of penalties upon it, paid to said Carl F. Routzahn, as Collector of Internal Revenue for the Eighteenth District of Ohio, under protest, the said sum of One Hundred Sixty-six Thousand Nine Hundred and Ten Dollars and one cent ($166,910.01);

That thereafter, to-wit, on March 18, 1924, the plaintiff duly filed with the Commissioner of Internal Revenue, according to the provisions of law in that regard and the regulations of the Secretary of the Treasury established [fol. 6] in pursuance thereof, a claim for refund of One Hundred Ninety-three Thousand Five Hundred and Ninety-eight Dollars and ninety-one cents ($193,598.91), together with interest thereon, being the sum of the One Hundred Sixty-six Thousand Nine Hundred and Ten Dollars and one cent ($166,910.01) illegally assessed and collected as aforesaid, and the Twenty-six Thousand Six Hundred and Eighty-eight Dollars and ninety cents ($26,688.90) illegally assessed and credited as aforesaid against the aforesaid erroneous and illegal additional assessment of federal income and profits taxes for the years 1916 and 1917; and that thereafter, to-wit, on January 8, 1925, said Commissioner of Internal Revenue rendered a decision rejecting and disallowing said claim for refund;

That the assessment against the plaintiff of said additional federal income and profits taxes in the sum of One Hundred Seventy-five Thousand and Fifty-three Dollars and thirty-five cents ($175,053.35) and interest thereon, aggregating the total sum of One Hundred Ninety-three Thousand Five Hundred and Ninety-eight Dollars and ninety-one cents ($193,598.91), for the years 1916 and 1917, was erroneous and illegal;

That by reason of the premises there is now due to the plaintiff from the defendant the sum of One Hundred Sixty-six Thousand Nine Hundred and Ten Dollars and one cent ($166,910.01) together with interest thereon from

July 14, 1923, at the rate of six per cent (6%) per annum.

Wherefore the plaintiff prays judgment against the defendant for the said sum of One Hundred Sixty-six Thousand Nine Hundred and Ten Dollars and one cent ($166,910.01) with interest thereon from July 14, 1923, at the rate of six per cent (6%) per annum, together with such further relief as may be proper in the premises.

M. B. & H. H. Johnson, Attorneys for Plaintiff.

[fol. 7] *Duly sworn to by John H. Watson, Jr. Jurat omitted in printing.*

Precipe—Filed Nov. 10, 1926

To the Clerk:

Issue summons on amended petition for the defendant, Carl F. Routzahn, returnable according to law, and endorse thereon "Action for money only,—amount claimed One Hundred Sixty-six Thousand Nine Hundred and Ten Dollars and one cent ($166,910.01) with interest thereon from July 14, 1923, at the rate of Six Per Cent (6%) per annum."

M. B. & H. H. Johnson, Attorneys for Plaintiff.

[fol. 8] In United States District Court

Answer to Amended Petition—Filed Nov. 20, 1926

Now comes A. E. Bernsteen, United States Attorney on behalf of C. F. Routzahn, defendant herein, and for answer to plaintiff's amended petition says:

Defendant admits the corporate existence of the plaintiff under the laws of the State of Ohio, with its present place of business at Cleveland, Ohio, its citizenship in the State and residence in the Eastern Division of the Northern District of Ohio; admits the official status of C. F. Routzahn as Collector of Internal Revenue; admits that C. F. Routzahn is a resident of said judicial district and that this is an action arising under the Internal Revenue Laws of the United States.

Defendant further answering denies each and every allegation contained in plaintiff's amended petition not herein specifically admitted to be true.

Wherefore plaintiff prays that the amended petition herein may be dismissed and that the plaintiff be ordered to pay the costs herein.

A. E. Bernsteen, United States Attorney.

Duly sworn to by A. E. Bernsteen. Jurat omitted in printing.

[fol. 9] IN UNITED STATES DISTRICT COURT

WAIVER OF JURY—Filed Nov. 11, 1927

We, the attorneys for the respective parties, hereby waive the trial to the jury of this cause, and agree to submit the same to the Court without the intervention of a jury.

M. B. & H. H. Johnson, Attorneys for Plaintiff.
A. E. Bernsteen, Attorney for Defendant.

IN UNITED STATES DISTRICT COURT

JURY WAIVED; TRIAL TO COURT; CAUSE TAKEN UNDER ADVISEMENT—Nov. 11, 1927

This day came the parties by their attorneys and, a jury having been waived, this cause came on to be heard by the Court on the pleadings and the evidence, and the Court, having heard all of the testimony adduced on behalf of the parties and the arguments of counsel, took said cause under advisement.

IN UNITED STATES DISTRICT COURT

DEFENDANT'S REQUEST FOR FINDINGS OF FACT AND CONCLUSIONS OF LAW—Filed Nov. 23, 1927

Based upon the oral and documentary evidence heretofore presented it is requested that the court make the following

[fol. 10] Findings of Fact

1. That the Aluminum Castings Company, the plaintiff herein, is and was at all times involved in this action, an Ohio corporation, with its principal office in the City of Cleveland.

2. That the defendant, Carl F. Routzahn, is now the Collector of Internal Revenue for the 18th District of Ohio and is the Collector to whom the taxes here involved were paid.

3. In the year 1916, the plaintiff corporation engaged in the manufacture of certain articles which were subject to the munitions manufacturers' tax under Title III of the Revenue Act of 1916. That this tax amounted to the sum of $246,275.63, which tax was paid to the then Collector of the 18th District of Ohio in the year 1917.

4. That in its corporation income tax return for the year 1916, duly filed with the proper officer, in ascertaining its taxable net income the plaintiff did not deduct the said munitions tax amounting to $246,275.63, as an expense for the said year 1916.

5. In its corporation income and profits tax returns for the year 1917, duly filed by the plaintiff with the then Collector of Internal Revenue for the 18th District of Ohio, the plaintiff did deduct the said munitions tax amounting to the sum of $246,275.63 in arriving at its net taxable income.

6. The Commissioner of Internal Revenue, upon audit and investigation of the plaintiff's books and corporation income and excess profits tax return, determined that the said munitions tax was a proper deduction for the year 1916. He, therefore, disallowed said deduction for the year 1917, which resulted in an additional income and profits tax for the year 1917, in the sum of $179,978.86, and an overassessment for the year 1916 in the sum of $4,925.51, making a net increase of $175,053.35. That by reason of a loss sustained in the year 1919, which, by statute, could be considered as a deduction for the year 1918, the Commissioner of Internal Revenue determined that

there should be refunded to this plaintiff the sum of $34,739.06, on the tax paid for the year 1918. This amount was refunded to the plaintiff by credit against the sum of $175,053.35. The plaintiff admits that of this credit of $34,739.06, $8,050.16 was properly applied. The deduction [fol. 11] of the remaining $26,688.90 of the said refund for 1918, which is not involved here, from the net additional tax of $175,053.35, leaves a balance of $148,364.45, which, together with interest paid at the time of payment of the tax in the sum of $18,545.56, makes a total of $166,910.01.

7. On March 18, 1924, claim for refund was filed as required by law, in the sum of $193,598.91, with interest, which amount includes the sum of $166,910.01, here involved.

8. That during the years 1916 and 1917 the books of the plaintiff were kept on the accrual basis.

9. That for the year 1916 the corporation income tax return, and for the year 1917 the corporation income tax return and its excess profits tax return were filed on the accrual basis.

Based upon the foregoing findings of fact, the court is requested to make the following

Conclusions of Law

1. That in determining the taxable net income of the plaintiff for the year 1916, the deduction of the munitions tax for that year in the sum of $46,275.63, was proper.

2. That judgment should be entered for the defendant for his costs and disbursements herein.

A. E. Bernsteen, United States Attorney.

In United States District Court

Memorandum Opinion—Filed Nov. 30, 1927

Westenhaver, District Judge:

This action is to recover back taxes paid under protest. All jurisdictional conditions precedent are admit-

ted. Jury trial has been waived in writing. The controversy involves the year in which should be deducted certain taxes on munitions manufactured by plaintiff. The [fol. 12] answer turns on the proper construction of Sections 12 (a) and 13 (d), Internal Revenue Act of 1916. This act was passed and became effective September 6, 1916. During the remainder of that year, plaintiff manufactured and sold munitions from which it derived certain profits, the tax on which, at the prescribed rate, aggregates $246,275.63. It paid these taxes in July, 1917, and included the same as a deduction from its income return for the year 1917 instead of 1916. The Commissioner of Internal Revenue later, upon auditing these returns, held that the tax should have been deducted from the income for the year 1916. The result of this transfer, together with certain corrections and credits for refunds, was an additional payment of $148,364.46, amounting, with interest, to $166,910.90, for which this action is brought.

The case is submitted partly on an agreed statement of facts and partly on oral and documentary testimony. The dispute between the parties is as to whether plaintiff's accounts during 1916 were kept upon an accrual basis, and whether plaintiff made its return upon that basis, rather than upon the basis of actual receipts and disbursements. The facts on which this issue turns, are not really in dispute. The difference between counsel turns rather upon an appreciation of well-established facts, or inferences properly deducible therefrom.

In my opinion, this case is in principle controlled by United States v. Anderson, 269 U. S. 422. The distinction between that case and the present case is based upon slight differences in the facts, which are not controlling. One of the major points then in dispute was whether Section 12 (a), despite Section 13 (d), required munition taxes to be deducted from the year in which they were paid. It was strongly urged that the fourth paragraph of Section 12 (a) did so require and that the provisions of Section 13 (d), authorizing income returns to be made upon the basis on which books were kept, i. e., an accrual basis, did not require the same to be deducted for the year during which the income subject thereto was being earned. It was held that if the return was made on an

accrual basis, as is permitted by Section 13 (d), and not on the basis of actual receipts and disbursements, the deduction should be made for the year in which the income was earned, and not in which it was paid. This major question of doubt being thus put at rest, nothing now is left for determination except whether plaintiff's [fol. 13] books of account for the year 1916 were kept on an accrual basis and its income return made on that basis.

My conclusion, briefly stated, is that plaintiff's books were so kept and its income return was so made, and that its munition tax on profits earned in 1916 was properly deductible from its income for that year, even though not paid until in 1917. The books are kept on an accrual basis whenever entries are made of credits and debits as the liability arises, whether then received or disbursed. In so keeping books, many entries will appear on the basis of actual receipts and disbursements. In a business of any complexity, books must be so kept in order to disclose correctly the actual state of business. In order to keep books on the basis of actual receipts and disbursements, credits yet to become due or obligations yet to be paid, would have to be ignored. Likewise in taking and entering inventory, work finished but not sold, or work in process, supplies required but not yet used, could not be included on a basis showing added values not yet received. Plaintiff's books were so kept.

The abstracts of counsel's argument, and the opinion of Mr. Justice Stone, in the Anderson case, set forth fully the history of the law as it bears on this controversy, and deal fully with all considerations necessary to be considered. It would serve no useful purpose to go over the same ground. It will be sufficient to state plaintiff's present contentions as I understand them. Plaintiff admits that its books were kept on a mixed basis, i. e., partly of actual receipts and disbursements, and partly of accrued earnings and expenses. It contends, however, that its income return was made on the basis of actual receipts and disbursements, as is provided in Section 12(a); that Section 13(d) confers merely an option of the taxpayer to make his return otherwise than on the basis of actual receipts and disbursements; that he exercised this option to make its return on this basis, correcting, for that purpose, such entries in its books as

were in the nature of accruals; and that, having so exercised this option, it was not within the power of the Commissioner of Internal Revenue to audit and correct its returns so as to conform the same to a return made on an accrual basis, as contemplated by Section 13(d), even though its books of account uncorrected might have permitted a return on that basis. In support of these contentions are urged various considerations, of which only the most weighty need be noticed.

[fol. 14] First, plaintiff, in its income return, declares that it is made on the basis of actual receipts and disbursements. Obviously, the taxpayer's declaration that his income return is being made in a certain way, is not controlling. This declaration must be tested by the actual facts. If these disclose that, in substance and effect, the return, as well as the books, is on another basis, the declaration must be disregarded. A basis of keeping books or of making a return, cannot be made other than what it actually is by the taxpayer's declaration.

Secondly, it is urged that plaintiff's income return was compiled and made in conformity to the practice and rulings prevailing under prior revenue laws, when returns could not be made otherwise than on the basis of actual receipts and disbursements. Section 12(a) is substantially the same as the corresponding section of the Revenue Act of 1913. Section 13(d) is a qualification of Section 12(a), appearing for the first time in the Revenue Act of 1916. Prior thereto the law did not authorize a return otherwise than on the basis of actual receipts and disbursements. As will appear from the abstracts of arguments and the opinion in the Anderson case, the law was not susceptible of literal administration upon this basis. Consequently the taxing authorities had permitted the making of returns according to what is called a mongrel system. In other words, notwithstanding the law, the taxpayer was required to include accounts and bills receivable and enhancement of inventory by work in progress or completed and not sold, as earnings, and was permitted to deduct therefrom bills payable and reserves and accruals established to take care of liabilities in process of accrual, but the amount of which was not yet determined. As books of account in all businesses of any magnitude or complexity were usually kept on an

accrual basis, the law probably could not have been administered in any other way. Under that law, returns thus made, were regarded as made on the basis of actual receipts and disbursements. Plaintiff, in making its income return for 1916, adopted and followed that system. The argument is that since what was done and accepted prior to the Revenue Act of 1916 as a return on the basis of actual receipts and disbursements, and since Section 12(a) is the same as the corresponding section of the prior law, its present re-[fol. 15] turn, made in the same form under the Act of 1916, must likewise be regarded as made on the basis of actual receipts and disbursements.

The argument is not without weight, but it was strongly urged in the Anderson case and was rejected. In substance, it is there held that Section 13(d) is a qualification of Section 12(a), and not only authorized the income return to be made in conformity to the taxpayer's method of keeping his accounts, provided they reflected clearly the net income, but, indeed, required the return to be so made if the taxpayer was unable to make a return except on that basis, and also that when he elected so to keep his books and so to make his return, he was bound by that election and must apply it consistently to all the items entering into the return. Of the purpose of this section, it was said: "It was to enable taxpayers to keep their books and make their returns according to scientific accounting principles, by charging against income earned during the taxable period, the expenses incurred in and properly attributable to the process of earning income during that period; and indeed, to require the tax return to be made on that basis, if the taxpayer failed or was unable to make the return on a strict receipts and disbursements basis." Such is plaintiff's situation.

Plaintiff entered on its books, accounts and bills receivable whenever a credit arose in its favor, regardless of the time when it might be received. It included in its inventory the increased value due to expenditures made in connection therewith. For instance, this inventory shows finished castings not sold, in the sum of $343,792.12; work in progress, in the sum of $77,742.10; supplies and material on hand in large amounts. As I understand the situation, all entries on the asset side of plaintiff's balance sheet are

made strictly on an accrual basis, and this applies equally to its income return. Likewise on the liability side are entered accounts payable, including unpaid labor and accrued taxes. Reserves are set up for commissions, legal expenses, unadjusted claims, liability and other insurance, and taxes, aggregating $313,475.39. Included in this aggregate is an item of $108,006.55 for federal income tax. It is testified that no reserve was set up for the munitions tax, but it appears that plaintiff at that time questioned whether its product was of such a nature as to be subject to that tax. [fol. 16] Plaintiff's income return conforms to its books as thus kept, with certain limited exceptions. It did not deduct in its return the full reserve of $108,006.55 set up for federal income tax, but only the amount of taxes actually paid during the year 1916. It did not deduct all of the other amounts set up as reserves. It may even be conceded that the other reserves were disregarded, except so far as actually used or necessary to discharge liabilities actually paid during 1916, or the amount of which was definitely ascertained. The fact remains, however, that plaintiff's books were kept and plaintiff's return was made substantially upon an accrual basis. It is probable that plaintiff could not have made an income return on a strict basis of actual receipts and disbursements. Section 13(d), as was said in the Anderson case, was enacted to meet this situation. Its effect is to compel a departure from the practice followed prior to 1916, whenever the taxpayer keeps his books or attempts to make his return otherwise than on a strict basis of receipts and disbursements, or when he is not able to make it in that way. An election results from what is done, notwithstanding the taxpayer may disclaim any such intention.

As I understand the facts of the Anderson case, they were not substantially different from the facts of this case. The difference most strongly stresseed is that in the Anderson case, a reserve, beginning with September, 1916, was in fact set up to take care of the munitions tax, whereas in this case none was set up, owing probably to the plaintiff's belief that its product was not subject to the munitions tax. But in the Anderson case that reserve was closed out by entry made December 31, 1916. A distinction cannot be based upon an entry thus made and later corrected, and

a mere failure to make any entry at all. The controlling facts of the two cases are the same.

It results from these views that judgment, with costs, should be entered for the defendant. Findings of fact were requested and will be made. Judgment will be withheld so as to permit the findings to be settled in conformity to District Court Rule 34. All proper exceptions will be allowed.

D. C. Westenhaver, Judge.

November 30, 1927.

[fol. 17] IN UNITED STATES DISTRICT COURT

PLAINTIFF'S REQUEST FOR SPECIAL FINDINGS OF FACT—Filed Dec. 10, 1927

The plaintiff herein, The Aluminum Castings Company, respectfully requests the court to make the following special findings of fact from the evidence herein:

(1) In the year 1916 the plaintiff made articles from which it derived a profit which was held to be subject to the tax imposed by Title III of the Revenue Act of 1916, and known as the munitions manufacturer's tax. The so-called munitions manufacturers' tax of the plaintiff imposed on profits made on munitions manufactured and sold in the year 1916 in the sum of $246,275.63 was paid to the United States Government by the plaintiff in the year 1917. In its federal income tax return for the year 1916 the plaintiff did not deduct from its gross income its said munitions manufacturers' tax of $246,275.63. The plaintiff, in its federal income and profits tax returns filed with the United States Internal Revenue Department for the year 1917, deducted the said munitions manufacturers' tax from its gross income. The Commissioner of Internal Revenue disallowed the said munitions manufacturers' tax of $246,275.63 paid by the plaintiff in the year 1917, as a deduction from the gross income of the plaintiff for the year 1917, and transferred it back as a deduction from the gross income of the plaintiff for the year 1916 in figuring the income and profits taxes of the plaintiff for said years, and also deducted the amount of said munitions manufacturers' tax from the invested capital of the plain-

tiff for the year 1917. By reason of the said transfer of the munitions manufacturers' tax deduction from the year 1917 to the year 1916 and the said decrease in the plaintiff's invested capital for the year 1917, the federal income and profits taxes of the plaintiff were increased for the year 1917 in the sum of $179,978.86 and decreased for the year 1916 in the sum of $4,925.51, making a net increase of $175,053.35 in said federal income and profits taxes for the years 1916 and 1917 on account of the said transfer of said munitions manufacturers' tax deduction from the year 1917 to the year 1916 and said decrease in invested capital, which sum was assessed against the plaintiff. The plaintiff duly filed with the Commissioner of Internal Revenue a claim for refund of the sum of $34,739.06 on account of 1918 income and profits taxes, and said claim [fol. 18] was allowed by said Commissioner of Internal Revenue, but said sum of $34,739.06, instead of being refunded in cash to the plaintiff, was credited by the United States Government $8,050.16 against certain miscellaneous additions to the federal income and profits taxes of the plaintiff for the years 1916 and 1917 (the amount of the said application not being in dispute in this case), and $26,688.90 against the aforesaid additional assessment of income and profits taxes in the sum of $175,053.35 made against the plaintiff for the years 1916 and 1917 on account of the said transfer of the said munitions manufacturers' tax from the year 1917 to the year 1916 and the said decrease of invested capital, leaving a balance of said assessment of $148,364.45. Thereafter Carl F. Routzahn, then Collector of Internal Revenue for the Eighteenth District of Ohio, notified the plaintiff that unless said sum of $148,364.45 and interest thereon amounting to $18,545.56, or a total of $166,910.01, was paid to him on or before July 14, 1923, penalties would be inflicted upon the plaintiff and the property of the plaintiff distrained and sold. Thereupon, to wit, on July 14, 1923, the plaintiff, although maintaining that the collection of said sum of $166,910.01 was illegal, but in order to avoid the distraint and the sale of its property and the imposition of penalties upon it, paid to said Carl F. Routzahn, as Collector of Internal Revenue for the Eighteenth District of Ohio, under protest, the said sum of $166,910.01. Thereafter, to wit, on

March 18, 1924, the plaintiff duly filed with the Commissioner of Internal Revenue, according to the provisions of law in that regard and the regulations of the Secretary of the Treasury established in pursuance thereof, a claim for refund of $193,598.91, together with interest thereon, being the sum of the $166,910.01 assessed and collected as aforesaid and the $26,688.90 assessed and credited as aforesaid against the aforesaid additional assessment of federal income and profits taxes for the years 1916 and 1917. Thereafter, to wit, on January 8, 1925, said Commissioner of Internal Revenue rendered a decision rejecting and disallowing said claim for refund.

(2) During the years 1916 and 1917 and previous thereto, the entries in the plaintiff's books of account were made as follows: The entries in some accounts were made on the so-called "accrual basis"; the entries in some accounts were made on the basis of actual cash receipts and disbursements; and the entries in some accounts were made [fol. 19] when the invoices of the items were made out or received by the plaintiff.

(3) Under the United States Revenue Act of 1913, income tax returns could not be made otherwise than on the basis of actual receipts and disbursements, and the regulations issued by the Commissioner of Internal Revenue specifically provided that reserves for taxes could not be allowed, and that interest and taxes could be deducted from gross income only in the year when actually paid; but the regulations issued by the Commissioner of Internal Revenue required that the gross income of manufacturing companies should consist of the total sales of manufactured goods during the year covered by the return, increased or decreased by the gain or loss as shown by the inventories of finished and unfinished products, raw material, etc. at the beginning and end of the year, and the Commissioner of Internal Revenue ruled that accounts and bills receivable of a corporation were to be treated as income for the year in which they were created, that is to say, in the year in which the accounts were set up on the books or the bills receivable were accepted, and that accounts payable, representing the ordinary and necessary expenses of maintain-

ing and operating the corporation's business and property, might be deducted from the gross income of the year in which the expenses were incurred.

(4) On September 14, 1916, after the enactment of the United States Revenue Act of 1916, the Commissioner of Internal Revenue issued the following ruling:

"Pending the adoption and promulgation of special regulations under the Act of September 8, 1916, Income Tax Regulations in force September 8, 1916, are hereby extended and made applicable to the act of September 8, 1916, so far as not inconsistent with the provisions of that statute."

(5) On January 8, 1917, the Commissioner of Internal Revenue made the following ruling:

"Sub-paragraph (d) of Sec. 13, of Title I, of the Act of September 8, 1916, provides that

'A corporation, joint stock company or association, or insurance company, keeping accounts upon any basis other than that of actual receipts and disbursements, unless such other basis does not clearly reflect its income, may, subject to regulations made by the Commissioner of Internal [fol. 20] Revenue with the approval of the Secretary of the Treasury, make its returns upon the basis upon which its accounts are kept, in which case the tax shall be computed upon its income as so returned.'

Under this provision it will be permissible for corporations which accrue on their books monthly or at other stated periods, amounts sufficient to meet fixed annual or other charges, to deduct from their gross income the amounts so accrued, provided such accruals approximate as nearly as possible the actual liabilities for which the accruals are made, provided that in cases wherein deductions are made on the accrual basis as hereinbefore indicated, income from fixed and determinable sources accruing to the corporations must be returned, for the purpose of the tax, on the same basis.

* * * * * * *

This ruling contemplates that the income and authorized deductions shall be computed and accounted for on the

same basis, and that the *the* same practice shall be consistently followed year after year. * * *

If, upon investigation, it shall be found that returns made upon the basis of accruals and reserves, do not reflect the true net income, the corporation so failing in this way to return the true net income, will not thereafter be permitted to make its returns upon any basis other than that of actual receipts and disbursements."

(6) The Internal Revenue Department's rulings and regulations hereinabove set forth remained unchanged down to and after uly 12, 1917, the date when the plaintiff's amended income tax return for the year 1916 was executed.

(7) On account of the plaintiff's bookkeeping department being behind in its work, the plaintiff was obliged, in the first instance, to file a tentative inaccurate return of income for the year 1916, and as soon as correct figures were available, to wit, in July, 1917, the plaintiff filed an amended income tax return for 1916 which was made up by the plaintiff's Secretary and auditor in conjunction with a government auditor who was then at the plaintiff's plant auditing the figures for the plaintiff's income tax return and mu- [fol. 21] nitions manufacturers' tax return for the year 1916. A copy of the plaintiff's income tax return and amended income tax return for the year 1916, marked respectively Exhibits A and B, are hereto attached and made a part hereof.

(8) The plaintiff's amended income tax return for the year 1916 was made out as follows: The gross income from operations was figured in the method provided for by the form of Item 3 on the reverse side of the income tax return blank furnished by the Internal Revenue Department, and the plaintiff's ordinary bills and accounts receivable and payable, arising from its manufacturing operations, were treated as cash receipts and disbursements on the dates when they were entered on the books, and the other items, including rentals and interest and taxes, were actual cash receipts and disbursements during the year.

(9) The plaintiff's amended income tax return for the year 1916 figured the income differently from the income shown on the plaintiff's books of account, in that, subject

to the method of figuring gross income from operations and the treatment of ordinary bills and accounts receivable and payable arising from the plaintiff's manufacturing operations hereinabove stated, the accruals and reserves on the plaintiff's books of account were omitted in figuring the plaintiff's income tax return. The taxes paid by the plaintiff during the year 1916 amounted to $26,493.44, and the taxes accrued or for which reserves were set up on the plaintiff's books during the year 1916, amounted to $130,-924.19.

(10) The plaintiff made out its amended income tax return for the year 1916 in the same way as it had done the previous year, and did not elect to avail itself of the privilege granted by Section 13(d) of the Act of September 8, 1916, to make its return upon the basis upon which its accounts were kept, unless the filing of said return, in itself, constituted such election.

(11) The plaintiff's amended income tax return for the year 1916 was audited and approved, as filed, by the Internal Revenue Department, and this audit and approval has never since been modified or questioned by the Internal Revenue Department except as to the one item of the munitions manufacturers' tax reduction.

(12) The munitions manufacturers' taxes of the plaintiff were never accrued on its books, nor were any reserves ever [fol. 22] set up against its munitions manufacturer's taxes. The first entry with reference to the munitions manufacturers' tax, which appears on the plaintiff's books, was in July, 1917, when the payment of the tax was entered on the plaintiff's books on the date when it was actually paid.

(13) On December 17, 1917, the Commissioner of Internal Revenue issued the following ruling:

"These provisions of law (Sec. 13(d) of the act of September 8, 1916) authorize corporations and joint stock companies, or associations, and insurance companies, keeping books of account on an accrued basis, to deduct from gross income in returns of annual net income the accrual of interest for the return year within the limits prescribed by the taxing acts when shown as a charge against accrued income upon the books of account."

There were no other pertinent income tax rulings made prior to March, 1918, when the income tax returns for the year 1917 had to be filed, Article 191, of Regulations 33, as it stood in March, 1918, reading as follows:

"Art. 191. Taxes Deductable.—Taxes imposed against a corporation by authority of the United States (except income and excess-profits taxes) its territories or any foreign country, or by authority of any State, county, school district, municipality, or other taxing sub-division of a State (not including those assessed against local benefits) and paid within the year for which the return is made, are deductible from the gross income of a domestic corporation."

(14) The plaintiff made up its income tax return for the year 1917 in the same way that it had made up its income tax return for the year 1916, and did not elect to avail itself of the privilege granted by Section 13(d) of the Act of September 8, 1916, to make its return upon the basis upon which its accounts were kept, unless the filing of said return, in itself, constituted such election. A copy of plaintiff's income and profits tax returns for the year 1917, marked respectively Exhibits C and D, are hereto attached and made a part hereof.

M. B. & H. H. Johnson, Attorneys for Plaintiff.

[fol. 23] In United States District Court

Memorandum Opinion—Filed Dec. 16, 1927

Westenhaver, J.:

In compliance with request of parties, special findings of fact from the evidence are made as follows:

1. That the Aluminum Castings Company, the plaintiff herein, is and was at all times involved in this action, an Ohio corporation, with its principal office in the City of Cleveland.

2. That the defendant, Carl F. Routzahn, is now the Collector of Internal Revenue for the 18th District of Ohio and is the Collector to whom the taxes here involved were paid.

3. In the year 1916, the plaintiff corporation engaged in the manufacture of certain articles which were subject to the munitions manufacturers' tax under Title III of the Revenue Act of 1916. That this tax amounted to the sum of $246,275.63, which tax was paid to the then Collector of the 18th District of Ohio in the year 1917.

4. That in its corporation income tax return for the year 1916, duly filed with the proper officer, in ascertaining its taxable net income the plaintiff did not deduct the said munitions tax amounting to $246,275.63, as an expense for the said year 1916.

5. In its corporation income and profits tax returns for the year 1917, duly filed by the plaintiff with the then Collector of Internal Revenue for the 18th District of Ohio, the plaintiff did deduct the said munitions tax amounting to the sum $246,275.63 in arriving at its net taxable income.

6. The Commissioner of Internal Revenue, upon audit and investigation of the plaintiff's books and corporation income and excess profits tax return, determined that the said munitions tax was a proper deduction for the year 1916. He, therefore, disallowed said deduction for the year 1917, which, resulted in an additional income and profits tax for the year 1917, in the sum of $179,978.86, and an over-assessment for the 1916 in the sum of $4,925.51, making a net increase of $175,053.35. That by reason of a loss sustained in the year 1919, which, by statute, could be consid- [fol. 24] ered as a deduction for the year 1918, the Commissioner of Internal Revenue determined that there should be refunded to this plaintiff the sum of $34,739.06, on the tax paid for the year 1918. This amount was refunded to the plaintiff by credit against the sum of $175,053.35. The plaintiff admits that of this credit of $34,739.06, $8,050.16 was properly applied. The deduction of the remaining $26,688.90 of the said refund for 1918, which is not involved here, from the net additional tax of $175,053.35, leaves a balance of $148,364.45, which, together with interest paid at the time of payment of the tax in the sum of $18,545.56, makes a total of $166,910.01.

7. That thereafter the defendant, as Collector of Internal Revenue for the 18th District of Ohio, notified plaintiff

that unless said sum of $148,364.45, with interest thereon amounting to $18,545.56, or a total of $166,910.01, was paid on or before July 14, 1923, penalties would be inflicted upon the plaintiff and that the property of the planitiff would be distrained and sold; and thereupon, to-wit, on July 14, 1923, plaintiff paid the said sum under protest and in order to avoid the imposition of penalties and levy and distraint upon its property.

8. That thereafter, to-wit, on March 18, 1924, a claim for refund was duly filed, as required by law, for the sum of $193,598.91, with interest, being the sum of $166,910.01 assessed and collected as aforesaid, and the sum of $26,668.90 assessed and credited as hereinbefore recited against the aforesaid additional assessment of federal and income profit taxes for the years 1916 and 1917, and that thereafter, to-wit, January 8, 1925, said Commissioner of Internal Revenue rejected and disallowed said claim for refund.

9. That during the years 1916 and 1917 plaintiff kept its accounts upon a basis other than that of actual receipts and disbursements, commonly known as an accrual basis.

10. That for the year 1916 the corporation income tax return, and for the year 1917 the corportion income tax return and excess profit tax return of plaintiff were made, returned, and filed on the basis on which its accounts were kept as aforesaid, viz., an accrual basis.

Based upon the foregoing findings of fact, the following conclusions of law are made:

[fol. 25] 1. That in determining the taxable net income of the plaintiff for the year 1916, the deduction of munitions tax for that year in the sum of $246,275.63 was properly made and in conformity to law.

2. That judgment should be rendered in defendant's favor with costs and disbursements herein properly taxable.

An exception on behalf of plaintiff is noted and allowed to each and all of the foregoing findings of fact, and particularly as to the findings 9 and 10, and also to each of the conclusions of law. The Clerk will enter judgment in accordance herewith.

D. C. Westenhaver, Judge.

December 16, 1927.

In United States District Court

Special Findings of Fact; Judgment for Defendant; Exceptions of Plaintiff Thereto—Dec. 20, 1927

In compliance with the request of parties, special findings of fact from the evidence are made by the Court as follows:

1. That the Aluminum Castings Company, the plaintiff herein, is and was at all times involved in this action an Ohio corporation, with its principal office in the City of Cleveland.

2. That the defendant, Carl F. Routzahn, is now the Collector of Internal Revenue for the 18th District of Ohio and is the Collector to whom the taxes here involved were paid.

[fol. 26] 3. In the year 1916, the plaintiff corporation engaged in the manufacture of certain articles which were subject to the munitions manufacturers' tax under Title III of the Revenue Act of 1916; that this tax amounted to the sum of $246,275.63, which tax was paid to the then Collector of the 18th District of Ohio, in the year 1917.

4. That in its corporation income tax return for the year 1916, duly filed with the proper officer, in ascertaining its taxable net income, the plaintiff did not deduct the said munitions tax amounting to $246,275.63, as an expense for the said year 1916.

5. In its corporation income and profits tax returns for the year 1917, duly filed by the plaintiff with the then Collector of Internal Revenue for the 18th District of Ohio, the plaintiff did deduct the said munitions tax amounting to the sum of $246,275.63, in arriving at its net taxable income.

6. The Commissioner of Internal Revenue, upon audit and investigation of the plaintiff's books and corporation income and excess profits tax return, determined that the said munitions tax was a proper deduction for the year 1916. He, therefore, disallowed said deduction for the year 1917, which resulted in an additional income and profits tax for the year 1917 in the sum of $179,978.86, and an over-

assessment for the year 1916 in the sum of $4,925.51, making a net increase of $175,053.35; that by reason of a loss sustained in the year 1919, which, by statute, could be considered as a deduction for the year 1918, the Commissioner of Internal Revenue determined that there should be refunded to this plaintiff the sum of $34,739.06 on the tax paid for the year 1918. This amount was refunded to the plaintiff by credit against the sum of $175,053.35. The plaintiff admits that of this credit of $34,739.06, $8,050.16 was properly applied. The deduction of the remaining $26,688.90 of the said refund for 1918, which is not involved here, from the net additional tax of $175,,053.35 leaves a balance of $148,364.45, which, together with interest paid at the time of payment of the tax in the sum of $18,545.56, makes a total of $166,910.01.

7. That thereafter the defendant, as Collector of Internal Revenue for the 18th District of Ohio, notified plaintiff that, unless said sum of $148,364.45, with interest thereon amounting to $18,545.56, or a total of $166,910.01, was paid [fol. 27] on or before July 14, 1923, penalties would be inflicted upon the plaintiff and that the property of the plaintiff would be distrained and sold; and thereupon, to-wit, on July 14, 1923, plaintiff paid the said sum under protest and on order to avoid the imposition of penalties and levy and distraint upon its property.

8. That thereafter, to-wit, on March 18, 1924, a claim for refund was duly filed, as required by law, for the sum of $193,598.91, with interest, being the sum of $166,910.01 assessed and collected as aforesaid and the sum of $26,668.90 assessed and credited as hereinbefore recited against the aforesaid additional assessment of federal and income profit taxes for the years 1916 and 1917, and that thereafter, to-wit, January 8, 1925, said Commissioner of Internal Revenue rejected and disallowed said claim for refund.

9. That during the years 1916 and 1917 plaintiff kept its accounts upon a basis other than that of actual receipts and disbursements, commonly known as an accrual basis.

10. That for the year 1916 the corporation income tax return and for the year 1917 the corporation income tax return and excess profit tax return of plaintiff were made,

returned and filed on the basis on which its accounts were kept as aforesaid, viz., an accrual basis.

It is thereupon ordered and adjudged by the Court that, in determining the taxable net income of the plaintiff for the year 1916, the deduction of munitions tax for that year in the sum of $246,275.63 was properly made and in conformity to law.

It is further ordered and adjudged by the Court that the defendent go hence without day and recover of the plaintiff his costs and disbursements herein expended taxed at $—, and that said plaintiff pay its own costs; to which judgment the plaintiff, The Aluminum Castings Company excepts. Said plaintiff excepts to the failure and refusal of the Court to find the findings of fact Nos. 1 to 14, inclusive, and each of them, and each and every part thereof, requested by the plaintiff, and excepts to the special findings of fact Nos. 1 to 10, inclusive, and each of them, found by the Court herein, and particularly to the special findings of fact Nos. 9 and 10, and each of them, found by the Court herein, [fol. 28] because said special findings of fact are contrary to the evidence and are not sustained by any evidence, and excepts to the conclusions of law Nos. 1 and 2, and each of them, made by the Court herein, because said conclusions of law are not sustained by any evidence and are contrary to the evidence and the law, and excepts to the judgment herein, because the facts found by the Court are not sufficient to support said judgment, and excepts to the judgment herein, because there is no evidence to support it and because said judgment is contrary to law.

In United States District Court

Motion for New Trial—Filed Dec. 20, 1927

Now comes the plaintiff, The Aluminum Castings Company, and moves the court to set aside the special findings of fact and conclusions of law heretofore found and made by the court herein, and each of them, and the judgment heretofore entered herein, and to grant a new trial for the following causes and reasons, to-wit:

1. The special findings of fact Nos. 1 to 10, inclusive, and each of them, found by the court herein are not sustained by sufficient evidence.

2. The special findings of fact Nos. 1 to 10, inclusive, and each of them, found by the court herein are not sustained by any evidence.

3. The conclusions of law Nos. 1 and 2, and each of them, made by the court herein are not sustained by sufficient evidence and are not sustained by any evidence and are contrary to law.

4. The court erred in refusing to find as special findings of fact herein plaintiff's requested special findings of fact Nos. 1 to 14, inclusive, and each of them.

[fol. 29] 5. The court erred in its findings of fact found herein, Nos. 1 to 10, and each of them.

6. The court erred in its conclusions of law made herein, Nos. 1 and 2, and each of them.

7. The judgment is not sustained by sufficient evidence, nor by any evidence, and is contrary to law.

8. The judgment is contrary to the weight of the evidence given upon the trial.

9. The facts found by the court are not sufficient to support the judgment.

M. B. & H. H. Johnson, Attorneys for Plaintiff.

Acknowledgment of Service of Notice

Service of notice of the above and foregoing motion for new trial, by copy thereof, is hereby acknowledged, December 19, 1927.

A. E. Bernsteen, Attorney for Defendant.

In United States District Court

Order Overruling Motion for New Trial—Jan. 21, 1928

This day this cause came on to be heard on the motion of plaintiff for a new trial and was argued by counsel, on

consideration thereof, the Court overruled said motion, to which ruling of the Court plaintiff, by its attorneys, excepts.

It is further ordered by the Court that the plaintiff have fifty (50) days in which to prepare, settle and file its bill of exceptions, in accord with General Rule No. 38.

[fol. 30] IN UNITED STATES DISTRICT COURT

ORDER ALLOWING BILL OF EXCEPTIONS—Feb. 2, 1928

This day the bill of exceptions in this case was presented to the Court, the same having been delivered to the Clerk by the excepting party in accordance with Rule 38 of the General Rules of this Court, and the adverse counsel having been notified of such delivery and no objections or suggestions thereto have been filed, the same is allowed and signed and ordered to be filed in this case.

IN UNITED STATES DISTRICT COURT

Plaintiff's Bill of Exceptions—Filed Feb. 2, 1928

Be it remembered that on the 11th day of November, 1927, being a day in the October, 1927, term of said Court, this cause came on for hearing before Hon. D. C. Westenhaver, one of the Judges of said Court, and the following proceedings were had:

PLAINTIFF'S CASE

To maintain the issues on its part, plaintiff introduced in evidence the following Stipulation of Facts which was agreed to in court by the parties through their respective counsel:

STIPULATION OF FACTS

In the year 1916 the plaintiff made articles from which it derived a profit, which was held to be subject to the tax imposed by Title III of the Revenue Act of 1916 and known as the Munitions Manufacturers' Tax. The so-called Muni-

tions Manufacturers' Tax of the plaintiff imposed on profits made on munitions manufactured and sold in the year 1916 in the sum of $246,275.63, was paid to the United States Government by the plaintiff in the year 1917. In its federal income tax return for the year 1916, the plaintiff did not [fol. 31] deduct from its gross income its said munitions manufacturers' tax of $246,275.63. The plaintiff in its federal income and profits tax returns filed with the United States Internal Revenue Department for the year 1917, deducted the said munitions manufacturers' tax from its gross income. The munitions manufacturers' taxes of the plaintiff were never accrued on its books, nor were any reserves ever set up against its munitions manufacturers' taxes. The Commissioner of Internal Revenue disallowed the said munitions manufacturers' tax of $246,275.63 paid by the plaintiff in the year 1917 as a deduction from the gross income of the plaintiff for the year 1917 and transferred it back as a deduction from the gross income of the plaintiff for the year 1916 in figuring the income and profits taxes of the plaintiff for said years, and also deducted the amount of said munitions manufacturers' tax from the invested capital of the plaintiff for the year 1917. By reason of the said transfer of the munitions manufacturers' tax deduction from the year 1917 to the year 1916, and the said decrease in the plaintiff's invested capital for the year 1917, the federal income and profits taxes of the plaintiff were increased for the year 1917 in the sum of $179,978.86, and decreased for the year 1916 in the sum of $4,925.51, making a net increase of $175,053.35 in said federal income and profits taxes for the years 1916 and 1917 on account of the said transfer of the said munitions manufacturers' tax deduction from the year 1917 to the year 1916, and said decrease in invested capital, which sum was assessed against the plaintiff. The plaintiff duly filed with the Commissioner of Internal Revenue a claim for refund of the sum of $34,739.06 on account of 1918 income and profits taxes, and said claim was allowed by said Commissioner of Internal Revenue, but said sum of $34,-739.06, instead of being refunded in cash to the plaintiff, was credited by the United States Government, $8,050.16, against certain miscellaneous additions to the federal income and profits taxes of this plaintiff for the years 1916

and 1917, the amount of said application not being in dispute in this case, and $26,688.90 against the aforesaid additional assessment of income and profits taxes in the sum of $175,053.35 made against the plaintiff for the years 1916 and 1917 on account of the said transfer of the said munitions manufacturers' tax from the year 1917 to the year 1916 and the said decrease of invested capital, leaving a [fol. 32] balance of said assessment of $148,364.45. Thereafter Carl F. Routzahn, then Collector of Internal Revenue for the Eighteenth District of Ohio, notified the plaintiff that unless said sum of $148,364.45 and interest thereon, amounting to $18,545.56, or a total of $166,910.01, was paid to him on or before July 14, 1923, penalties would be inflicted upon the plaintiff and the property of the plaintiff distrained and sold. Thereupon, to wit, on July 14, 1923, the plaintiff, although maintaining that the collection of said sum of $166,910.01 was illegal, but in order to avoid the distraint and the sale of its property and the imposition of penalties upon it, paid to the said Carl F. Routzahn, as Collector of Internal Revenue for the Eighteenth District of Ohio, under protest, the said sum of $166,910.01. Thereafter, to wit, on March 18, 1924, the plaintiff duly filed with the Commissioner of Internal Revenue, according to the provisions of law in that regard, and the regulations of the Secretary of the Treasury, established in pursuance thereof, a claim for refund of $193,598.91, together with interest thereon, being the sum of $166,910.01, assessed and collected as aforesaid, and the $26,688.90 assessed and credited as aforesaid against the aforesaid additional assessment of federal income and profits taxes for the years 1916 and 1917. Thereafter, to wit, on January 8, 1925, said Commissioner of Internal Revenue rendered a decision rejecting and disallowing said claim for refund.

And further to maintain the issues on its part, the plaintiff called as a witness JOHN H. WATSON, JR., who being first duly sworn, testified as follows:

Direct examination by Mr. Scott:

My full name is John H. Watson, Jr. I live at 2029 East 40th Street, Cleveland. My occupation is that of lawyer,

and I am associated with the firm of M. B. & H. H. Johnson, of Cleveland, Ohio. I am the Secretary and a director of The Aluminum Castings Company, the plaintiff in this case. I have been Secretary of The Aluminum Castings Company since February 1, 1917. Prior to February 1, 1917, I worked for The Aluminum Castings Company, helping Mr. George Cook Ford who was then the Secretary of that Company. Mr. Ford died in January, 1917. As Secretary of The Aluminum Castings Company, I made out the income tax returns of The Aluminum Castings [fol. 33] Company for the years 1916 and 1917 and the excess profits tax return of the Company for the year 1917. With respect to preparing these tax returns, I gave instructions to the auditing department of The Aluminum Castings Company as to the figures to furnish me, and they furnished the figures and I made out the tax returns. I dealt with Mr. A. H. Basler in the Auditing Department of The Aluminum Castings Company. I told Mr. Basler to give me the figures for the tax returns on a cash receipt and disbursement basis, but that he might treat the so-called bills and accounts receivable and payable of the corporation as cash receipts and disbursements on the days on which they were entered on the books. Mr. Basler subsequently furnished me the figures pursuant to my request, and I used those figures in making out the tax returns for 1916 and 1917. After Mr. Basler furnished the figures, I made out the returns, and Mr. Basler and I went over the the returns and checked them. The figures on the returns were accurate pursuant to that check. For the year 1916 The Aluminum Castings Company filed an income tax return and then filed an amended income tax return. The tax return for the year 1916 was due on March 1, 1917, and The Aluminum Castings Company's auditors didn't have their figures available at that time, and I went to the Collector's office at Cleveland and got an extension of thirty days. When that thirty days was up, the auditors still didn't have the figures for me, and I thought that I could not get another extension, and so we made out a return with tentative figures which were not entirely accurate, and then we were going to file an amended return, which we did. We filed the amended return in July, 1917. The circumstances that brought about

the late closing of the books of The Aluminum Castings Company for the year 1916 were that the business of The Aluminum Castings Company for the year 1916 doubled; it increased some seven or eight million dollars, and the bookkeeping department was way behind. I do not know accurately when the books were finally closed for 1916, but it was some time between the end of March, 1917, and July 12, 1917. I know upon what basis the income tax returns for 1916 and 1917 and the excess profits tax return for 1917 of The Aluminum Castings Company were made. The returns were made on a cash receipt and disbursement basis. The books of the Company, for instance, in [fol. 34] the case of taxes, contained accruals of certain taxes, but in making the income tax returns, the taxes reported for the years 1916 and 1917, as well as the previous year, 1915, were all reported on the basis of the actual cash expenditures for taxes in those years. What I have said with respect to taxes, applies to the returns as a whole. The amended tax return of The Aluminum Castings Company for the year 1916 was made out by Mr. Basler and me in connection with a government auditor named Mr. Roethe, who was out there and who also prepared the munitions tax return that was filed at the same time as the amended income tax return. The 1916 tax return of The Aluminum Castings Company was audited by the government auditor on the basis of cash receipts and disbursements. There was no deduction in the return for the accrued income tax or any munitions tax or any local taxes of any nature for the year 1916. The Aluminum Castings Company never exercised the option given under Section 13 of the Revenue Act of 1916, to make its tax returns on the basis on which its books were kept. The Aluminum Castings Company never accrued munitions taxes on its books, nor did it ever set up any reserve against them. The books of The Aluminum Castings Company were not kept on any consistent basis. There were some accruals, and then there was some items that were entered on a cash receipt and disbursement basis. The Aluminum Castings Company was a company that grew, and the way the system of bookkeeping grew up was merely historical. In making its tax returns for the years 1916 and 1917, The Aluminum Castings Company

reported its taxes that it actually paid in those years respectively. The only entry with reference to the munitions manufacturers' tax of The Aluminum Castings Company for the year 1916, which was paid in July, 1917, was the entry of the payment of the tax, paid some time in July, 1917, after July 12th,—about a week afterwards. That is the first entry on the books of The Aluminum Castings Company with reference to the munitions tax liability of the Company. The date of the entry of the munitions tax on the books of the Company was the same date on which the munitions tax was paid. We took the Corporation Trust Company's Tax Service, and I followed the Internal Revenue laws and the Treasury Department Regulations and the various rulings as they came out through the years 1914, 1915, 1916, 1917, 1918 and 1919.

[fol. 35] Thereupon counsel for plaintiff introduced in evidence a certified copy of the original income tax return of The Aluminum Castings Company for the year 1916, of the amended income tax return of The Aluminum Castings Company for the year 1916, of the income tax return of The Aluminum Castings Company for the year 1917, and of the excess profits tax return of The Aluminum Castings Company for the year 1917. Said documents were marked respectively plaintiff's Exhibits 1, 2, 3 and 4, and are hereto attached and made a part hereof.

Counsel for plaintiff then introduced in evidence the following Treasury Department opinions, regulations and decisions: Law Opinion 1059, Cumulative Bulletin No. 4, January-June, 1921, page 148; Regulations 33, Article 156; Regulations 33, Article 158; Regulations 33, Article 148; letter addressed to Carey, Piper and Hall, Baltimore, Maryland, signed by Acting Commissioner David A. Gates, dated March 2, 1915, found in Corporation Trust Company's Income Tax Service for 1915, at page 441; Regulations 33, Article 104; ruling of W. H. Osborn, Commissioner of Internal Revenue, dated September 14, 1916; Treasury Decision 2433, handed down on January 8, 1917; Treasury Decision 2625; Regulations 33, Article 191. Copies of said documents, marked plaintiff's Exhibit 7, are hereto attached and made a part hereof.

When I made the tax returns of The Aluminum Castings Company for the years 1916 and 1917, I was familiar with these various Regulations, Treasury Decisions, Law Opinions and laws, to which plaintiff's counsel has referred, except one that was — in 1920. The rest of them antedated the making out of these tax returns, and I was familiar with them at the time that I made out the returns.

Cross-examination by Mr. Wheeler:

I am not an accountant but I have had some experience with books. My idea of an accrual is that where you have any income or liability that accrues over a stated period, you put it on your books over that period. In case of a sale that The Aluminum Castings Company made today and they expect to get the money next year, it is not necessarily my interpretation of it that they would enter that [fol. 36] on the books today as cash. The system that they had out there was that when they put the item on the books, that was the date they treated it as cash. That is neither an accrual nor perhaps, if you use language strictly, is it actual cash, but the Treasury Department rule said that that was a cash receipt and disbursement basis. We would not put the item on the books until we had invoiced it to our purchaser; that was the regular practice. We put the item on our books before we got the money. The date of the invoice was the date it went on the books. If we sold a bill of goods today and it was invoiced today, we would enter it as cash today. Then at some future date we got the money. An invoice of that kind would be an account receivable. The returns for 1916 and for 1917 and also for 1915 were made on the same basis. I think that there was no change in the method of keeping accounts during those years; at least there was no change in the tax returns during those three years. On The Aluminum Castings Company's income tax return for the year 1917, marked Plaintiff's Exhibit 3, under the heading "Basis of Return," in answer to the question, "Is this return made on the basis of actual receipts and disbursements?" the answer is "Yes, except as below indicated," and then below is "Bills and accounts payable and receivable are treated as receipts and disbursements." On the

return for 1916 the same question is answered by the word "Yes." The basis of the return for 1916 was exactly the same as the return for 1917, bills and accounts payable and receivable being entered as cash. It is not true that these returns were made on both the cash and the accrual basis. I can explain the difference by an illustration. If I rent a property, for example, for the year 1927; and the rental is payable to me, we will say, on January 15, 1928; now if our books were on an accrual basis, the rental would be set up on our books monthly during 1927. That was not our system. Our system was to set that up on January 15, 1928, when we invoiced the rent for 1927. We did not accrue these amounts at all. There were some accruals on The Aluminum Castings Company's books but The Aluminum Castings Company's tax returns did not follow its books. Its books showed some accruals and some cash receipt and disbursement entries. I am familiar enough with accounting to state whether or not you could keep books on an accrual basis without entering some cash [fol. 37] items. The fact that an accrual and a payment happen to coincide, would not prevent the books being on the accrual basis. Even though your books were strictly on the accrual basis, there would probably be a few cash entries. The gross income from operation of The Aluminum Castings Company as shown on Plaintiff's Exhibit 1 is $9,583,194.76. That amount was determined from the figures in Item 3 on the reverse side of the return. Those figures are reflected by the inventory taken. The stock on hand at the close of the year is set forth in Item 3 and the purchases during the year are added, and the sales during the year are deducted, and the gross sales thus determined. That is the inventory basis that we used there. The inventory basis of determining income does not reflect either the accrual or the cash receipt and disbursement method of return. It can be used with either method. In the balance sheet for December 31, 1916, attached to Plaintiff's Exhibit 4, the item "Inventory" is carried as an asset. The item, "Finished Castings $343,000.00" represents the inventory value of the finished castings. I don't know whether that was the cost to the Company at that time. I imagine that the item is put in there as an asset because the Company expects the return of at least that

much money for those finished castings. I do not recall at that time what the inventory basis was; whether it was cost, or cost or market, whichever is lower. Whether it is cost, or cost or market, whichever is lower, I imagine that the Company expected the return of at least that much money upon the sale of those castings, or they would not have made them. The inventory is necessarily an asset. The work in process is the cost of castings to their then present stage of completion. The Company, of course, expected to receive the return of this amount and any additional amount that it puts into the castings to complete them. The item on the balance sheet of December 31, 1916, of "Accounts Receivable, Less Reserves, $2,226,149.24" is the accounts receivable as they stood on our books on December 31, 1916, less a reserve that was set up against that account. I would not say that the amount there is an accrual. The reserve would be an accural, but I didn't use the reserve in making out the tax return. The item on the balance sheet is a balance of two items. You will find accounts receivable and the reserve item, and the figure in the balance sheet is the difference. The reserves are deducted from the gross accounts receivable to make that [fol. 38] item. I do not consider the accounts receivable of two million dollars and the item of "notes receivable" as an accrual. That is the balance from the notes receivable account as they stood on our books. It had not been paid to us. I would have to look at the maturity of the notes to see when I think they would be paid. They would be paid at some future date. The items of accounts payable are in the same category as accounts receivable. We treated them both just the same. "Unpaid Labor" is labor that has been performed but not paid for. I would say that probably, from the size of the item, it was made up of two kinds: one is unclaimed wages and the other is wages that had been earned and not paid. In the balance sheet there appears the items of "Accrued Taxes, $5,000.00." The "reserves for commisions, for liability insurance, for fire insurance, for legal expense, for high priced metal, for federal income tax, for open receiving slips, for unadjusted claims," appearing there, are set up to take care of future possible expenditures or present unliquidated liabilities. This item of "Accrued Taxes"

and these reserves did not come into our income tax returns. These are all shown in the books; and this is the balance sheet. The accounts receivable and accounts payable and bills receivable and bills payable were taken into consideration on our income tax return. They were treated as cash receipts and disbursements at the time they were entered on the books. The munitions tax was not deducted from The Aluminum Castings Company's 1916 tax return. There was some question in the mind of the Company as to whether or not it was liable for the tax. That had nothing to do with the fact that the munitions tax was not deducted from the 1916 income tax return. There wasn't a single tax that was deducted, either on the 1916 return or the 1917 return, that wasn't paid during that year. If Mr. Roethe, the government auditor, had deducted taxes for the year 1916 on the accrued basis, there would have been over one hundred thousand dollars more taxes deducted in 1916 than were deducted. Referring to Plaintiff's Exhibit 3 and the particular item 3a, under the heading "Income From Gross Sales and Other Income From Operations, $18,679,704.16," this amount was determined as set forth in Item 4a on the back of the return on page 2. That particular item sets out the inventories at the beginning and at the end of the year. The 1917 in- [fol. 39] come tax return was not accepted by the government. It was audited. It was the 1916 amended return that was made up by us in connection with the government. The amended return for 1916 was made out by Mr. Basler and me in connection with Mr. Roethe, who was the government auditor. We all agreed on that return. Now, afterwards, another auditor came along and he changed that 1916 return in just one respect, and that was he shifted the munitions tax back into 1916 and used that as a deduction for 1916, and that auditor did not accrue any other taxes in 1916 except these munitions taxes.

Redirect examination by Mr. Scott:

Mr. Roethe was an auditor from the Internal Revenue Department. I made up the amended return for 1916 in conjunction with Mr. Roethe and Mr. Basler. Mr. Roethe made out the munitions tax return for 1916. We executed the munitions tax return and the amended income tax re-

turn for 1916 on the same day, and, I think, filed them on the same day. In making up the income tax return for 1916, Mr. Roethe did not deduct the munitions tax. For each of the years 1916 and 1917 there was one standard form for making corporation income tax returns. There was a slight change in the form between 1916 and 1917, if I remember correctly. For the year 1916 there was one particular form that the government supplied. We had to use this form; and the same was true for 1917. In both of these years, if we were going to make the income tax return at all, I understood that we would have to follow the government form. That government form was the form that provided this so-called inventory method, as Mr. Wheeler calls it, in connection with gross sales and other income from operations. It is made by taking the inventory at the beginning of the year and at the end of the year, and purchases and sales in the meantime.

Recross-examination by Mr. Wheeler:

I contend that because there was an inventory form on that return, we had to fill it out, and not only that, but the rulings and regulations of the Commissioner of Internal Revenue, prior to that date, provided for treating the returns just the same as we treated them. Mr. Basler, Mr. Roethe and I all worked on the income tax return for 1916.

[fol. 40] Thereupon the plaintiff called as a witness Albert H. Basler, who, being first duly sworn, testified as follows:

Direct examination by Mr. Scott:

My full name is Albert H. Basler. I live at 1065 Carlyon Road, East Cleveland. My business at the present time is Treasurer of The Forest City Rubber Company. At the present time I have no connection with The Aluminum Castings Company or with any company allied with or subsidiary to The Aluminum Castings Company. I was at one time employed by The Aluminum Castings Company. I entered into the employ of that Company in February, 1916, and continued in the employ of The Aluminum Castings

Company through 1916, 1917, 1918 and 1919. During those years I was employed by The Aluminum Castings Company as an accountant, and was in complete charge and responsible for the books of the Company. I had something to do with the preparation of the income tax returns of The Aluminum Castings Company for the years 1916 and 1917, and with the preparation of the excess profits tax return of that Company for the year 1917. The Treasurer of the Company, who was my superior officer at the time, instructed me to furnish figures to make up these returns for Mr. Watson, the Secretary of the Company. That is the Mr. Watson who previously testified in this case. Subsequent to receiving those instructions from my superior officer, I took up the matter with Mr. Watson. He instructed us to furnish him with figures from which he could prepare the returns on the cash receipt and disbursement basis, considering accounts payable and receivable as cash receipts and disbursements on the day when they were entered on the books of the Company. I received those instructions both with respect to the years 1916 and 1917, and pursuant to those instructions, I prepared the figures and submitted them to Mr. Watson, and prepared the returns in conjunction with him. After those returns were prepared, I checked the figures on them, and the figures were accurate. The figures on each and all of the returns were upon the cash receipt and disbursement basis; that is, considering accounts receivable and payable as cash receipts and disbursements. I had no occasion to do any work with respect to the 1915 income tax return of The Aluminum Castings Company. The Aluminum Castings [fol. 41] Company never accrued munitions taxes on its books, nor did it ever set up any reserve against them. I am familiar with the basis upon which the books of The Aluminum Castings Company were kept during 1916 and 1917. The basis on which the books were kept during those years would be considered a more or less mixed basis, but was founded on previous history and previous practice, which had been handed down and carried through for a number of years. In other words, there were some accruals and there were some entries strictly on a cash basis. The items that were accrued were accrued particularly to enable the plant managers to be furnished with certain in-

formation as to bonuses or profits during the year. In making out the tax returns of The Aluminum Castings Company for the years 1916 and 1917, taxes were reported on the basis of cash paid. I don't know the date when the munitions tax paid by The Aluminum Castings Company about July, 1917, was entered on the books of the Company, but it was the date when it was paid. It was in about the middle of the year 1917.

Cross-examination by Mr. Wheeler:

I would say that the accounts receivable and accounts payable, when entered on the books of the Company, are not considered as accruals. The reason is that when a customer is billed for material, that is a completed transaction and does not necessarily constitute——. You haven't got the money then. I suppose a strictly cash basis might be founded on the actual receipt of money. I would not consider that a bills receivable or an invoice, or the entry of an item when the goods are invoiced, is an accrual. My idea of an accrual is that it is an item which is a liability that would have to be taken care of some time in the future.

The Court: But the amount of it not yet determined during the time you are making the accrual to take care of that unknown certainty when it will arrive, but entering a definite part of it from month to month over a period. Am I right?

The Witness: Yes, that is what I would say.

The Court: If you have, for instance, paid insurance for two or three years in the past, as the time ran on, you would accrue as an earning or an asset a proportion of that advance paid; that is what your idea of accrual is?

[fol. 42] The Witness: Yes, sir.

I would not say that an item could not be accrued because the amount of it could not be determined.

The Court: Nor you would not say it could not be accrued if it was determined.

Q. If it was on a strictly accrual basis, the item is fixed when the liability is fixed, and he does not receive the cash until a later date, then that would be an accrual, would it not?

A. No, I don't say so; I would say not.

The Court: Don't you think that is a matter for the Court to determine rather than the witness?

The books of the plaintiff for the years 1916 and 1917 were on a mixed basis. In the balance sheet of December 31, 1916, attached to Plaintiff's Exhibit 4, I consider the item "Reserve for Depreciation" a part of the surplus account.

Q. Referring to "prepaid expenses," do you consider that as an accrual?

A. Let me think about that for a minute.

The Court: Of course, if you prepaid expenses, you have to enter it somewhere?

The Witness: Yes.

The Court: If you enter it as an expense, you would enter it some place?

The Witness: They would make the entry when the cash was actually paid.

The fact is that the books of The Aluminum Castings Company showed items on the accrual basis and showed items on the cash basis. It is not possible for a set of books on the accrual basis not to show some cash items.

The Court: Well, is it possible to keep books on the cash basis that would not show some accrual items?

The Witness: No, I would not think so.

The Court: I think that is quite evident.

Thereupon the plaintiff rested.

Motion to Dismiss

Mr. Wheeler: I wish at this time to move for dismissal of these actions. The testimony has shown that the books [fol. 43] of this plaintiff were on a mixed basis, so-called, and such a basis is not recognized at law, and it seems to me that the case is specifically controlled by the decisions of the Supreme Court.

The Court: Now, wouldn't it be better, if you have any testimony, to hear that and dispose of the whole thing? In that way, I won't have to render an opinion that does not represent my studied judgment.

Thereupon, to maintain the issues on his part, the defendant called as a witness Arthur Murray Dewey, who, being first duly sworn, testified as follows:

Direct examination by Mr. Wheeler:

My full name is Arthur Murray Dewey. I live at 1564 Ansel Road. My occupation is that of accountant. I am a certified public accountant. I am employed by Steel & Tubes, Incorporated. I was formerly employed by the government as Revenue Agent and Auditor. As such Revenue Agent and Auditor, I examined the books of The Aluminum Castings Company for the years 1916 and 1917. I made that examination in the spring of 1927. From that examination I can state that the books of the plaintiff were kept on the accrual basis. I base my statement on this: it is very unusual for a corporation of the size of The Aluminum Castings Company to be on any other basis but an accrual basis; but my own reason for making such a statement is that they use accounts receivable and payable, the inventory, and accrued various items on their books as representing a liability that had not been paid in cash at the present time, but was to be paid in the future; it has been incurred but not paid. I apply that to the bills and accounts payable as well as to items of insurance and taxes. On a cash basis you do not take into consideration accounts receivable and payable. You only take in the actual money that is received. In other words, if you make a sale, and a man does not pay, you don't make any records on your books until you get that money. I was with the government four years and ten months.

[fol. 44] Q. During that time how many systems, or how many methods of accounting were brought to your attention which were recognized by the Government?

Mr. Scott: I object.

A. Two.

The Court: You may answer. I don't understand that is controlling on the Court, as reflecting on the questions I will have to decide, but he has answered the question, and the answer may stand. Proceed.

Those two systems are cash basis and accrual basis. I examined the income tax return filed by the plaintiff for the year 1916 and also for the year 1917, and have given them some consideration. The net income, as shown on the return, was considerably more than the net income as shown on the books. But I want to say that by saying "net income" as shown on the books, I mean the net credit in the profit and loss account at the end of the year, after taking in all the items of expenses as taken on the books. I have no papers of any kind with me. I am no longer in the government service. I worked in connection with making this examination with Mr. Cohen, who is also a Revenue Agent. He is in court now. We made our report in connection or in conjunction. Referring to that report to refresh my recollection, I can state that for the year 1916 there is a difference between the net income as reflected by the books of the taxpayer and the net income as shown on the return filed by the taxpayer, of $4,703.44.

Cross-examination by Mr. Scott:

Prior to the Revenue Act of 1916 the taxpayer had to make his income tax returns on a cash basis. That was the only recognized basis for making a tax return prior to the Act of 1916. I stated that I considered that the books of The Aluminum Castings Company were kept on an accrual basis because of the fact that they put on their books their bills and accounts receivable and payable as of the dates that the invoices were rendered, and mentioned several other items in connection.

Q. Now, Mr. Dewey, aren't you familiar with the fact that under the regulations prior to the Act of 1916 and during which time returns had to be made on a cash receipt [fol. 45] and disbursement basis, you were permitted to treat accounts receivable and payable as cash receipts and disbursements on the date upon which they were entered upon your books?

Mr. Wheeler: I wish to object to that question. That applies, if it applies at all, to the year 1915, prior to the return here in question for the year 1916.

The Court: I will overrule the objection.

Mr. Wheeler: Save an exception, if the Court please.

A. May I make a statement? I was not in the service at that time. I never did any work on any 1914 or '15 returns. It was no part of my job to know that law; so I am simply saying that I don't remember.

Q. Well, did you ever become familiar with the letter addressed by Acting Commissioner David A. Gates to Carey, Piper & Hall, of Baltimore, Maryland, dated March 2, 1915?

A. On March 2, 1915, I was not in the employ of the Government. I have never seen such a letter.

Q. Well, you are not familiar with it?

A. I have no knowledge of it.

I think that I testified that between the net income as shown on the books of The Aluminum Castings Company and as shown in the 1916 return, there was a difference of $4,703.44. In arriving at that difference, I might say that I didn't use any net income, because I didn't examine that year. I might explain the difference by saying that the previous agents who had examined the books and records of the Company, found there was that difference between the returns as filed and the books of the Company. The agent states in the report that it is unreconciled difference. In other words, the corporation had made out the return, using a certain figure which was different from the books, and that he was unable to explain that, and evidently they were unable to explain it to him. I am not able to explain it. I presume the return is wrong in not agreeing with the books. The return is that much larger than the books. The net income exceeded the books by that figure. I have no knowledge of the amended return. These figures are based on the original return. I believe that the time that I spent in making the examination of the books of The Aluminum [fol. 46] Castings Company was approximately a day or perhaps a shorter amount. I spent enough of my time to satisfy myself as to the issues in question. As a matter of fact, it might very possibly have been less than half a day.

Q. Now, prior to the Revenue Act of 1916, did a taxpayer have a right to use the inventory in making up his tax return?

A. Prior to the Revenue Act of 1916—as I stated before, I am not familiar with the regulations prior to the Act of 1916.

The Court: You don't feel qualified to answer that question?

The Witness: No, sir.

Q. Mr. Dewey, in 1916, federal income taxes were a proper deduction, were they not?

The Court: Just a moment; that is a pretty broad question. I think the Court would have to determine that. I do not know whether testimony on that subject would help us any. I don't know whether he is an expert or not.

A. I have no figures as to what taxes were accrued on the books of The Aluminum Castings Company for 1916. It wasn't the province of my report to go into the figures in detail, for the books of the Company were here. The extent of my examination was that I just went there to examine the method of bookkeeping in order to satisfy myself whether it had been kept on an accrual or cash basis. I used the report of the prior examiner, which was furnished me. It had an unreconciled balance.

Q. How were the rents received, put on the books of The Aluminum Castings Company?

A. If you show me the account, I will be able to tell you.

Q. Do you know?

A. I don't remember any specific items in the books of that nature at all.

Q. You don't know, as a matter of fact, whether they were put on on the cash receipt basis?

A. As I stated before, my examination convinced me that the books had been kept on the accrual basis. Now, it is a very common thing in books which are kept on the accrual basis, to find certain items which are incorrectly handled through deficiencies in the accounting force or bookkeeping errors, so a particular item like that I would not remember. [fol. 47] Q. And you have no memorandum from which you can refresh your recollection?

A. I don't think the report here would go into such detail. The books will speak for themselves.

Q. Do you know how many accounts were put on the books of The Aluminum Castings Company, on what you call an accrual basis?

A. The question is so vague I cannot answer how many accounts.

Q. Well, do you know how many accounts were carried on the books of The Aluminum Castings Company on a cash basis?

A. I could not say. There were some accounts that were handled on a cash basis, yes.

Thereupon the defendant called as a witness BENTON COHEN, who, being first duly sworn, testified as follows:

Direct examination by Mr. Wheeler:

My full name and address is Benton Cohen, 2099 East 71st Street, Cleveland, Ohio. My present occupation is that of Internal Revenue Agent in the Cleveland office. I have been so employed a little over five years. I am a certified public accountant for the State of Ohio. In the course of my duties in the office of the Internal Revenue Agent in Cleveland, I have examined the books of The Aluminum Castings Company for the years 1916 and 1917. That examination was made in April, 1927. The purpose of that examination was to satisfy ourselves that the books of the Company had been kept on the accrual basis. My conclusion was that they were kept on the accrual basis. That conclusion was based upon the fact that the Company had accrued items of expense, carried deferred charges as assets, and the fact that the Company was using inventories in ascertaining their profit and loss. I examined the income tax returns and excess profits tax returns for the years 1916 and 1917, filed by this Company. They appeared to be filed on the accrual basis. This statement is based upon the fact that they had used inventories in ascertaining their cost of goods, as well as the fact that they took the accounts receivable and the accounts payable in consideration as cash items, showing them on the accrual basis. In the course of that examination, I examined the balance sheet attached to the returns filed by The Aluminum Castings Company for 1917. I found items on there [fol. 48] which, as an accounting proposition, are indicative of the accrual system of keeping books. Those items are Prepaid Expenses, $20,455.94,—that is the balance sheet as of December 31, 1916,—Inventory $1,685,164.22, Accounts

Receivable, Less Reserv. , $2,226,149.24, Notes Receivable, $25,000.00. There are Accounts Payable set up on the books of $1,668,409.20; Unpaid Labor, $19,619.90; there are reserves on the books; some of them appear to be merely surplus allocation accounts, and others are accrued liabilities. The accrued liabilities are "Reserves for Commissions," amounting to $88,913.87. There is "Accrued Taxes" on the books of $5,481.13, "Reserve for Legal Expenses" of $4,075.05. Work in process or finished castings is in the inventory, the total figure that I gave. The inventory figures there show what was merely the material, what was partly finished, and work in progress, supplies and so forth.

Cross-examination by Mr. Scott:

I made just one examination of the books of The Aluminum Castings Company, and that was in conjunction with Mr. Dewey. We were out there all day. We got there about 9:15 or 9:30. I could not say on what basis the rent account on the books of The Aluminum Castings Company was carried. I don't remember that that was on a cash basis. I remember the accrued taxes, unpaid labor and deferred expenses. I could not say offhand, with respect to the accrued taxes for 1916, how much in taxes was accrued on the books of The Aluminum Castings Company for that year, but I can tell from my reports. December 31, 1916, the accrued taxes amounted to $5,481.13. That is per the books. These are the figures I have on that subject. Those were the taxes that were accrued during 1916 according to my examination of the books. At the end of December 31, 1916, there appears a reserve for federal taxes on the books of The Aluminum Castings Company of $108,006.55, as a separate item; so that they had set up at least $108,006.55 as a reserve against federal taxes alone. According to my figures, it is not a fact that the total reserve on the books of The Aluminum Castings Company for taxes for the year 1916 amounted to $130,924.19. My figures show accrued taxes for the year of $5,481.13, and the reserve for federal taxes of $108,006.55. The total of the two items is $113,487.68. I do not know offhand what taxes The Aluminum [fol. 49] Castings Company deducted in its income tax return for 1916.

The Court: If the income tax return shows for itself, what is it?

Mr. Scott: The income tax return of The Aluminum Castings Company for 1916, as amended, shows taxes $26,493.44.

The Court: That is the deduction?

Mr. Scott: Yes, that is the deduction.

The Witness: Taxes paid: $26,493.44. That tax would not include the federal income tax.

Q. The federal income taxes were deductible in 1916?

A. For the year 1916—federal income tax?

Q. Yes.

A. No, sir.

Q. They were not?

A. They were not.

The Court: You mean the '15 taxes paid in '16, or the '16 taxes paid in '17—what are you referring to?

Mr. Scott: No, the 1916 taxes.

The Witness: The 1916 taxes would not be paid until some time in 1917.

Q. I will change that. Were those taxes deducted in '16 or '17?

A. They were deducted in '17. That is, the '16 taxes were not deductible in the year 1917 as federal income taxes. That was a surplus charge and not considered an expense item.

Q. Were they deductible in 1916?

A. Yes.

Mr. Wheeler: I wish to object to this as not proper cross-examination.

The Court: I don't think it is proper cross-examination. I don't think it means anything. That is something that will have to be determined by somebody else than this witness. What this witness thinks about it is not evidence on the subject. It is probably a question of law.

Q. Now, Mr. Cohen, I hand you here a sheet that shows an analysis of the accrued tax account and reserve for federal income tax for the year 1916 of The Aluminum Castings Company. Will you tell me whether or not that is accurate?

Mr. Wheeler: Of course, I wish to object to the introduction of this document as not properly verified.

[fol. 50] Mr. Scott: I am asking him to verify it.

The Court: I will sustain the objection to that. He wasn't put on the witness stand for that purpose. If you want that in the record, you can put it in as part of your case.

Q. Now, Mr. Cohen, under the Revenue Act, prior to the Revenue Act of 1916, the only recognized basis for keeping accounts was that of actual receipts and disbursements; that is true, isn't it?

Mr. Wheeler: If the Court please, I object to that as not proper cross-examination.

The Court: I don't think he has any right to answer that question for the Court, anyhow. I sustain the objection.

Q. Mr. Cohen, when you came out to The Aluminum Castings Company to make this audit, isn't it a fact you told the people there you had come to make an audit for 1925?

Mr. Wheeler: If the Court please, I wish to object to that. It is absolutely immaterial and not proper cross-examination.

The Court: What do you claim for that, Mr. Scott?

Mr. Scott: Well, it shows the circumstances when he came, and what he was engaged in doing, and whatever he did with respect to 1916 or 1917 must have been just a casual examination.

The Court: Well, that would not follow from what he told them. If during the same period of time, he said he was working on this, he was in fact, doing something else, and didn't do anything else but make a casual examination, well and good. I don't think it reflects on his credit as a witness if he did tell them of an intent to do something else. Besides, I cannot see that you folks differ about anything here as to the real facts. It is your appreciation of the facts you are differing about and are wanting the witness to undertake to appreciate them for you, when it is none of your business.

Mr. Scott: The thing is this: the witness testified the tax returns were made on an accrual basis.

The Court: Certainly, and he gives his reasons for saying so; well and good. If his reasons do not support his contention, well and good. What does the fact of what he told [fol. 51] the people when he went out there to make an examination, have to do with his opinion about the revenue laws of 1916? What his opinion is as to what the law required in 1916, cannot have any relevancy to the issue as to whether these books were made and kept on an accrual basis.

A. With respect to the year 1917, the books of The Aluminum Castings Company show accrued taxes, at December 31, 1917, of $471,234.99. That is a reserve for federal taxes. I find that figure under "Reserves" on the balance sheet of December 31, 1917, attached to the Corporation Excess Profits Tax Return. I have not got the detail of this figure of four hundred seventy-one odd thousand dollars. That figure of four hundred seventy-one odd thousand dollars represents the amount in the account at December 31, 1917, rather than the accruals made during the year. This figure is the balance in the account during the year. Certain credits were made to the account and certain charges were made, and there was a balance at the beginning of the year, and there is a balance at the end; but that figure represents the balance at the end of the year in that account. I have not got the figures on the accruals that were made during the year. This is the balance of the figure in that account. There is a difference between the balance at the end of the year and what was accrued during the year; there would be some debits to the account also. I haven't given any opinion as to the accruals made during the year. All I have got is the figure at the end of the year.

Redirect examination by Mr. Wheeler:

The item of Accrued Taxes of five thousand odd dollars, and the reserve of one hundred and eight thousand, concerning which I have testified, were taken directly from the balance sheet of the Company submitted with the return for the year 1917.

Thereupon the defendant rested.

[fol. 52] PLAINTIFF'S REBUTTAL TESTIMONY

Thereupon the plaintiff called as a witness IVAN C. WEBER, who, being first duly sworn, testified as follows:

Direct examination by Mr. Scott:

My full name is Ivan C. Weber. I live at 2970 Edgehill Road, Cleveland Heights. I am employed by The United States Aluminum Company. At the request of Mr. Scott, I made up a statement of the accrued tax account and reserve for federal income taxes for the year 1916 of The Aluminum Casting Company. This is the statement. The statement is an actual copy from the books of The Aluminum Castings Company. I did the same thing with respect to the year 1917. This is the statement that I made up. It is accurate.

Thereupon counsel for plaintiff introduced in evidence the statements, and they were marked Plaintiff's Exhibits 5 and 6. Said documents are hereto attached and made a part hereof.

Mr. Wheeler: If the Court please, we wish to object to the introduction of these documents. Under the stipulation of facts, it is agreed that the particular tax upon which this action was based, was not accrued in 1916 or 1917. These documents are incompetent, irrelevant and immaterial, and it doesn't make any difference whether the accruals were made or how much.

The Court: Well, I will receive it for what it is worth.

Mr. Wheeler: Save an exception.

Both sides rested.

Mr. Wheeler: If the Court please, I wish to present a motion and be heard at this time of the Court cares to consider it.

The Court: Submit the motion.

MOTION TO DISMISS

Mr. Wheeler: The defendant at this time moves for judgment and dismissal of this case, based upon the evidence introduced, and it shows, as the Court will recollect,

that the books of the plaintiff company are kept either on the accrual basis or on a mixed basis, either one of the two systems. There is no contention made that the books are kept on a cash basis.

[fol. 53] The Court: I want your motion. Is that your motion?

Mr. Wheeler: Yes, sir.

The Court: Now, that is your whole case, is it? When you present that as a motion, that presents the question of asking me to decide the case in your favor under the facts and the law. The motion may or may not be helpful in the proceedings.

Mr. Wheeler: Do I understand my motion is overruled?

The Court: No; that is carried along.

Mr. Wheeler: And if it is adverse, I may have an exception?

The Court: Yes, you may have an exception if it is adverse. I consider that as a request to decide it that way.

The foregoing, together with the exhibits introduced on the foregoing trial, which are hereto attached and made a part hereof, is all of the evidence offered or received on the trial of the above entitled case.

DEFENDANT'S REQUEST FOR FINDINGS OF FACT AND CONCLUSIONS OF LAW

Thereupon the defendant presented to the court its request for findings of fact and conclusions of law, as follows:

Based upon the oral and documentary evidence heretofore presented it is requested that the court make the following

Findings of Fact

1. That the Aluminum Castings Company, the plaintiff herein, is and was at all times involved in this action, and an Ohio corporation, with its principal office in the City of Cleveland.

2. That the defendant, Carl F. Routzahn, is now the Collector of Internal Revenue for the 18th District of Ohio and is the Collector to whom the taxes here involved were paid.

3. In the year 1916, the plaintiff corporation engaged in the manufacture of certain articles which were subject to the munitions manufacturers tax under Title III of the Revenue Act of 1916. That this tax amounted to the sum [fol. 54] of $246,275.63, which tax was paid to the then Collector of the 18th District of Ohio in the year 1917.

4. That in its corporation income tax return for the year 1916, duly filed with the proper officer, in ascertaining its taxable net income the plaintiff did not deduct the said munitions tax amounting to $246,275.63, as an expense for the said year 1916.

5. In its corporation income and profits tax returns for the year 1917, duly filed by the plaintiff with the then Collector of Internal Revenue for the 18th District of Ohio, the plaintiff did deduct the said munitions tax amounting to the sum of $246,275.63 in arriving at its net taxable income.

6. The Commissioner of Internal Revenue, upon audit and investigation of the plaintiff's books and corporation income and excess profits tax return, determined that the said munitions tax was a proper deduction for the year 1916. He, therefore, disallowed said deduction for the year 1917, in the sum of $179,978.86, and an overassessment for the year 1916 in the sum of $4,925.51, making a net increase of $175,053.35. That by reason of a loss sustained in the year 1919, which, by statute, could be considered as a deduction for the year 1918, the Commissioner of Internal Revenue determined that there should be refunded to this plaintiff the sum of $34,739.06, on the tax paid for the year 1918. This amount was refunded to the plaintiff by credit against the sum of $175,053.35. The plaintiff admits that of this credit of $34,739.06, $8,050.16 was properly applied. The deduction of the remaining $26,688.90 of the said refund for 1918, which is not involved here, from the net additional tax of $175,053.35, leaves a balance of $148,364.45, which, together with interest paid at the time of payment of the tax in the sum of $18,545.56, makes a total of $166,910.01, the amount which was paid on July 14, 1923, and is the amount here involved.

7. On March 18, 1924, claim for refund was filed as required by law, in the sum of $193,598.91, with interest,

which amount includes the sum of $166,910.01, here involved.

8. That during the years 1916 and 1917 the books of the plaintiff were kept on the accrual basis.

9. That for the year 1916 the corporation income tax return, and for the year 1917 the corporation income tax [fol. 55] return and its excess profits tax return were filed on the accrual basis.

Based upon the foregoing findings of fact, the court is requested to make the following

Conclusions of Law

1. That in determining the taxable net income of the plaintiff for the year 1916, the deduction of the munitions tax for that year in the sum of $246,275.63, was proper.

2. That judgment should be entered for the defendant for his costs and disbursements herein.

Plaintiff's Request for Findings of Fact

Thereupon tht plaintiff presented to the court its request for findings of fact, as follows:

The plaintiff herein, The Aluminum Castings Company, respectfully requests the court to make the following special findings of fact from the evidence herein:

(1) In the year 1916 the plaintiff made articles from which it derived a profit which was held to be subject to the tax imposed by Title III of the Revenue Act of 1916, and known as the munitions manufacturers' tax. The so-called munitions manufacturers' tax of the plaintiff imposed on profits made on munitions manufactured and sold in the year 1916 in the sum of $246,275.63 was paid to the United States Government by the plaintiff in the year 1917. In its federal income tax return for the year 1916 the plaintiff did not deduct from its gross income its said munitions manufacturers' tax $246,275.63. The plaintiff, in its federal income and profits tax returns filed with the United States Internal Revenue Department for the year 1917,

deducted the said munitions manufacturers' tax from its gross income. The Commissioner of Internal Revenue disallowed the said munitions manufacturers' tax of $246,275.63 paid by the plaintiff in the year 1917, as a deduction from the gross income of the plaintiff for the year 1917, and transferred it back as a deduction from the gross income of the plaintiff for the year 1916 in figuring the income and profits taxes of the plaintiff for said years, and also deducted the amount of said munitions manufacturers' tax from the invested capital of the plaintiff for the year 1917. By reason of the said transfer of the munitions manufac- [fol. 56] turers' tax deduction from the year 1917 to the year 1916 and the said decrease in the plaintiff's invested capital for the year 1917, the federal income and profits taxes of the plaintiff were increased for the year 1917 in the sum of $179,987.86 and decreased for the year 1916 in the sum of $4,925.51, making a net increase of $175,053.35 in said federal income and profits taxes for the years 1916 and 1917 on account of the said transfer of said munitions manufacturers' tax deduction from the year 1917 to the year 1916 and said decrease in invested capital, which sum was assessed against the plaintiff. The plaintiff duly filed with the Commissioner of Internal Revenue a claim for refund of the sum of $34,739.06 on account of 1918 income and profits taxes, and said claim was allowed by said Commissioner of Internal Revenue, but said sum of $34,739.06, instead of being refunded in cash to the plaintiff, was credited by the United States Government $8,050.16 against certain miscellaneous additions to the Federal income and profits taxes of the plaintiff for the years 1916 and 1917 (the amount of the said application not being in dispute in this case), and $26,688.90 against the aforesaid additional assessment of income and profits taxes in the sum of $175,053.35 made against the plaintiff for the years 1916 and 1917 on account of the said transfer of the said munitions manufacturers' tax from the year 1917 to the year 1916 and the said decrease of invested capital, leaving a balance of said assessment of $148,364.45. Thereafter Carl F. Routzahn, then Collector of Internal Revenue for the Eighteenth District of Ohio, notified the plaintiff that unless said sum of $148,364.45 and interest thereon amounting to $18,545.56, or a total of $166,910.01, was paid to him on or before July 14, 1923, penalties would be inflicted upon the plaintiff and

the property of the plaintiff distrained and sold. Thereupon, to wit, on July 14, 1923, the plaintiff, although maintaining that the collection of said sum of $166,910.01 was illegal, but in order to avoid the distraint and the sale of its property and the imposition of penalties upon it, paid to said Carl F. Romzahn, as Collector of Internal Revenue for the Eighteenth District of Ohio, under protest, the said sum of $166,910.01. Thereafter, to wit, on March 18, 1924, the plaintiff duly filed with the Commissioner of Internal Revenue, according to the provisions of law in that regard and the regulations of the Secretary of the Treasury established in pursuance thereof, a claim for refund of $193,-[fol. 57] 598.91, together with interest thereon, being the sum of the $166,910.01 assessed and collected as aforesaid and the $26,688.90 assessed and credited as aforesaid against the aforesaid additional assessment of federal income and profits taxes for the years 1916 and 1917. Thereafter, to wit, on January 8, 1925, said Commissioner of Internal Revenue rendered a decision rejecting and disallowing said claim for refund.

(2) During the years 1916 and 1917 and previous thereto, the entries in the plaintiff's books of account were made as follows: The entries in some accounts were made on the so-called "accrual basis"; the entries in some accounts were made on the basis of actual cash receipts and disbursements; and the entries in some accounts were made when the invoices of the items were made out or received by the plaintiff.

(3) Under the United States Revenue Act of 1913, income tax returns could not be made otherwise than on the basis of actual receipts and disbursements, and the regulations issued by the Commissioner of Internal Revenue specifically provided that reserves for taxes could not be allowed, and that interest and taxes could be deducted from gross income only in the year when actually paid; but the regulations issued by the Commissioner of Internal Revenue required that the gross income of manufacturing companies should consist of the total sales of manufactured goods during the year covered by the return, increased or decreased by the gain or loss as shown by the inventories of finished and unfinished products, raw material, etc. at

the beginning and end of the year, and the Commissioner of Internal Revenue ruled that accounts and bills receivable of a corporation were to be treated as income for the year in which they were created, that is to say, in the year in which the accounts were set up on the books or the bills receivable were accepted, and that accounts payable, representing the ordinary and necessary expenses of maintaining and operating the corporation's business and property, might be deducted from the gross income of the year in which the expenses were incurred.

(4) On September 14, 1916, after the enactment of the United States Revenue Act of 1916, the Commissioner of Internal Revenue issued the following ruling:

"Pending the adoption and promulgation of special regulations under the Act of September 8, 1916, Income Tax [fol. 58] Regulations in force September 8, 1916, are hereby extended and made applicable to the act of September 8, 1916, so far as not inconsistent with the provisions of that statute."

(5) On January 8, 1917, the Commissioner of Internal Revenue made the following ruling:

"Sub-paragraph (d) of Sec. 13, of Title I, of the Act of September 8, 1916, provides that

'A corporation, joint stock company or association, or insurance company, keeping accounts upon any basis other than that of actual receipts and disbursements, unless such other basis does not clearly reflect its income, may, subject to regulations made by the Commissioner of Internal Revenue with the approval of the Secretary of the Treasury, make its returns upon the basis upon which its accounts are kept, in which case the tax shall be computed upon its income as so returned.'

Under this provision it will be permissible for corporations which accrue on their books monthly or at other stated periods, amounts sufficient to meet fixed annual or other charges, to deduct from their gross income the amounts so accrued, provided such accruals approximate as nearly as possible the actual liabilities for which the accruals are made, and provided that in cases wherein deductions are made on the accrual basis as hereinbefore

indicated, income from fixed and determinable sources accruing to the corporations must be returned, for the purpose of the tax, on the same basis.

* * * * * * *

This ruling contemplates that the income and authorized deductions shall be computed and accounted for on the same basis, and that the same practice shall be consistently followed year after year. * * *

If, upon investigation, it shall be found that returns made upon the basis of accruals and reserves, do not reflect the true net income, the corporation so failing in this way to return the true net income, will not thereafter be permitted to make its returns upon any basis other than that of actual receipts and disbursements."

[fol. 59] (6) The Internal Revenue Department's rulings and regulations hereinabove set forth remained unchanged down to and after July 12, 1917, the date when the plaintiff's amended income tax return for the year 1916 was executed.

(7) On account of the plaintiff's bookkeeping department being behind in its work, the plaintiff was obliged, in the first instance, to file a tentative inaccurate return of income for the year 1916, and as soon as correct figures were available, to wit, in July, 1917, the plaintiff filed an amended income tax return for 1916 which was made up by the plaintiff's Secretary and auditor in conjunction with a government auditor who was then at the plaintiff's plant auditing the figures for the plaintiff's income tax return and munitions manufacturers' tax return for the year 1916. A copy of the plaintiff's income tax return and amended income tax return for the year 1916, marked respectively Exhibits A and B, are hereto attached and made a part hereof.

(8) The plaintiff's amended income tax return for the year 1916 was made out as follows: The gross income from operations was figured in the method provided for by the form of Item 3 on the reverse side of the income tax return blank furnished by the Internal Revenue Department, and the plaintiff's ordinary bills and accounts receivable

and payable, arising from its manufacturing operations, were treated as cash receipts and disbursements on the dates when they were entered on the books, and the other items, including rentals and interest and taxes, were actual cash receipts and disbursements during the year.

(9) The plaintiff's amended income tax return for the year 1916 figured the income differently from the income shown on the plaintiff's books of account, in that, subject to the method of figuring gross income from operations and the treatment of ordinary bills and accounts receivable and payable arising from the plaintiff's manufacturing operations hereinabove stated, the accruals and reserves on the plaintiff's books of account were omitted in figuring the plaintiff's income tax return. The taxes paid by the plaintiff during the year 1916 amounted to $26,493.44, and the taxes accrued or for which reserves were set up on the plaintiff's books during the year 1916, amounted to $130,924.19.

[fol. 60] (10) The plaintiff made out its amended income tax return for the year 1916 in the same way as it had done the previous year, and did not elect to avail itself of the privilege granted by Section 13 (d) of the Act of September 8, 1916, to make its return upon the basis upon which its accounts were kept, unless the filing of said return, in itself, constituted such election.

(11) The plaintiff's amended income tax return for the year 1916 was audited and approved, as filed, by the Internal Revenue Department, and this audit and approval has never since been modified or questioned by the Internal Revenue Department except as to the one item of the munitions manufacturers' tax deduction.

(12) The munitions manufacturers' taxes of the plaintiff were never accrued on its books, nor were any reserves ever set up against its munitions manufacturers' taxes. The first entry with reference to the munitions manufacturers' tax, which appears on the plaintiff's books, was in July, 1917, when the payment of the tax was entered on the plaintiff's books on the date when it was actually paid.

(13) On December 17, 1917, the Commissioner of Internal Revenue issued the following ruling:

"These provisions of law (Sec. 13 (d) of the act of September 8, 1916) authorized corporations and joint stock companies, or associations, and insurance companies, keeping books of account on an accrued basis, to deduct from gross income in returns of annual net income the accrual of interest for the return year within the limits prescribed by the taxing acts when shown as a charge against accrued income upon the books of account."

There were no other pertinent income tax rulings made prior to March, 1918, when the income tax returns for the year 1917 had to be filed, Article 191 of Regulations 33, as it stood in March, 1918, reading as follows:

"Art. 191. Taxes Deductible.—Taxes imposed against a corporation by authority of the United States (except income and excess-profits taxes) its territories or any foreign country, or by authority of any State, county, school district, municipality, or other taxing sub-division of a State (not including those assessed against local benefits) and paid within the year for which the return is made, [fol. 61] are deductible from the gross income of a domestic corporation."

(14) The plaintiff made up its income tax return for the year 1917 in the same way that it had made up its income tax return for the year 1916, and did not elect to avail itself of the privilege granted by Section 13 (d) of the Act of September 8, 1916, to make its return upon the basis upon which its accounts were kept, unless the filing of said return, in itself, constituted such election. A copy of plaintiff's income and profits tax returns for the year 1917, marked respectively Exhibits C and D, are hereto attached and made a part hereof.

Exhibits "A" and "B" referred to in the foregoing request (7) are the same as Exhibits 1 and 2 attached hereto and made a part hereof, and Exhibits "C" and "D" in in the foregoing request (14) are the same as Exhibits 3 and 4 attached hereto and made a part hereof.

COURT'S FINDINGS OF FACT AND CONCLUSIONS OF LAW

Thereupon the court made the following special findings of fact and conclusions of law, to wit:

In compliance with request of parties, special findings of fact from the evidence are made as follows:

1. That the Aluminum Castings Company, the plaintiff herein, is and was at all times involved in this action, an Ohio corporation, with its principal office in the City of Cleveland.

2. That the defendant, Carl F. Routzahn, is now the Collector of Internal Revenue for the 18th District of Ohio and is the Collector to whom the taxes here involved were paid.

3. In the year 1916, the plaintiff corporation engaged in the manufacture of certain articles which were subject to the munitions manufacturers' tax under Title III of the Revenue Act of 1916. That this tax amounted to the sum of $246,275.63, which tax was paid to the then Collector of the 18th District of Ohio in the year 1917.

4. That in its corporation income tax return for the year 1916, duly filed with the proper officer, in ascertaining its taxable net income the plaintiff did not deduct the said munitions tax amounting to $246,275.63, as an expense for the said year 1916.

[fol. 62] 5. In its corporation income and profits tax returns for the year 1917, duly filed by the plaintiff with the then Collector of Internal Revenue for the 18th District of Ohio, the plaintiff did deduct the said munitions tax amounting to the sum of $246,275.63 in arriving at its net taxable income.

6. The Commissioner of Internal Revenue, upon audit and investigation of the plaintiff's books and corporation income and excess profits tax return, determined that the said munitions tax was a proper deduction for the year 1916. He, therefore, disallowed said deduction for the year 1917, which resulted in an additional income and profits tax for the year 1917, in the sum of $179,978.86, and an overassessment for the year 1916 in the sum of $4,925.51, making a net increase of $175,053.35. That by reason of a loss sustained in the year 1919, which, by statute, could be considered as a deduction for the year 1918, the Commissioner of Internal Revenue determined

that there should be refunded to this plaintiff the sum of $34,739.06, on the tax paid for the year 1918. This amount was refunded to the plaintiff by credit against the sum of $175,053.35. The plaintiff admits that of this credit of $34,739.06, $8,050.16 was properly applied. The deduction of the remaining $26,688.90 of the said refund for 1918, which is not involved here, from the net additional tax of $175,053.35, leaves a balance of $148,364.45, which, together with interest paid at the time of payment of the tax in the sum of $18,545.56, makes a total of $166,910.01.

7. That thereafter the defendant, as Collector of Internal Revenue for the 18th District of Ohio, notified plaintiff that unless said sum of $148,364.45, with interest thereon amounting to $18,545.56, or a total of $166,910.01, was paid on or before July 14, 1923, penalties would be inflicted upon the plaintiff and that the property of the plaintiff would be distrained and sold; and thereupon, to wit, on July 14, 1923, plaintiff paid the said sum under protest and in order to avoid the imposition of penalties and levy and distraint upon its property.

8. That thereafter, to wit, on March 18, 1924, a claim for refund was duly filed, as required by law, for the sum of $193,598.91, with interest, being the sum of $166,910.01 assessed and collected as aforesaid, and the sum of $26,668.90 assessed and credited as hereinbefore recited, against the aforesaid additional assessment of federal and income [fol. 63] profit taxes for the year 1916 and 1917, and that thereafter, to wit, January 8, 1925, said Commissioner of Internal Revenue rejected and disallowed said claim for refund.

9. That during the years 1916 and 1917 plaintiff kept its accounts upon a basis other than that of actual receipts and disbursements, commonly known as an accrual basis.

10. That for the year 1916 the corporation income tax return, and for the year 1917 the corporation income tax return and excess profit tax return of plaintiff were made, returned, and filed on the basis on which its accounts were kept as aforesaid, viz., an accrual basis.

Based upon the foregoing findings of fact, the following conclusions of law are made:

1. That in determining the taxable net income of the plaintiff for the year 1916, the deduction of munitions tax for that year in the sum of $246,275.63 was properly made and in conformity to law.

2. That judgment should be rendered in defendant's favor with costs and disbursements herein properly taxable.

An exception on behalf of plaintiff is noted and allowed to each and all of the foregoing findings of fact, and particularly as to the findings 9 and 10, and also to each of the conclusions of law. The Clerk will enter judgment in accordance herewith.

Thereupon the plaintiff excepted to the failure and refusal of the court to find the findings of fact Numbers 1 to 14, inclusive, and each of them, and each and every part thereof, requested by the plaintiff; and excepted to the special findings of fact Numbers 1 to 10, inclusive, and each of them, found by the court, and particularly to the special findings of fact Numbers 9 and 10, and each of them, found by the court, because said special findings of fact are contrary to the evidence and are not sustained by any evidence; and excepted to the conclusions of law Numbers 1 and 2, and each of them, made by the court, because said conclusions of law are not sustained by any evidence and are contrary to the evidence and the law; and excepted to judgment being entered for the defendant, because the facts found by the court are not sufficient to support such judgment; and excepted to judgment being entered for the defendant, because there is no evidence to support such judg-
[fol. 64] ment, and because such judgment is contrary to law.

JUDGMENT

Thereupon on December 20, 1927, the court entered judgment for the defendant, in the words and figures following, to wit:

In compliance with the request of parties, special findings of fact from the evidence are made by the Court as follows:

1. That the Aluminum Castings Company, the plaintiff herein, is and was at all times involved in this action, an

Ohio corporation, with its principal office in the City of Cleveland.

2. That the defendant, Carl F. Routzahn, is now the Collector of Internal Revenue for the 18th District of Ohio and is the Collector to whom the taxes here involved were paid.

3. In the year 1916, the plaintiff corporation engaged in the manufacture of certain articles which were subject to the munitions manufacturers' tax under Title III of the Revenue Act of 1916. That this tax amounted to the sum of $246,275.63, which tax was paid to the then Collector of the 18th District of Ohio in the year 1917.

4. That in its corporation income tax return for the year 1916, duly filed with the proper officer, in ascertaining its taxable net income the plaintiff did not deduct the said munitions tax amounting to $246,275.63, as an expense for the said year 1916.

5. In its corporation income and profits tax returns for the year 1917, duly filed by the plaintiff with the then Collector of Internal Revenue for the 18th District of Ohio, the plaintiff did deduct the said munitions tax amounting to the sum of $246,275.63 in arriving at its net taxable income.

6. The Commissioner of Internal Revenue, upon audit and investigation of the plaintiff's books and corporation income and excess profits tax return, determined that the said munitions tax was a proper deduction for the year 1916. He, therefore, disallowed said deduction for the year 1917, which resulted in an additional income and profits tax for the year 1917, in the sum of $179,978.86, and an over-[fol. 65] assessment for the year 1916 in the sum of $4,925.-51, making a net increase of $175,053.35. That by reason of a loss sustained in the year 1919, which, by statute, could be considered as a deduction for the year 1918, the Commissioner of Internal Revenue determined that there should be refunded to this plaintiff the sum of $34,739.06, on the tax paid for the year 1918. This amount was refunded to the plaintiff by credit against the sum of $175,053.35. The plaintiff admits that of this credit of $34,739.06, $8,050.16 was properly applied. The deduction of the remaining $26,688.90 of the said refund for 1918, which is not in-

volved here, from the net additional tax of $175,053.35, leaves a balance of $148,364.45, which, together with interest paid at the time of payment of the tax in the sum of $18,545.56, makes a total of $166,910.01.

7. That thereafter the defendant, as Collector of Internal Revenue for the 18th District of Ohio, notified plaintiff that unless said sum of $148,364.45, with interest thereon amounting to $18,545.56, or a total of $166,910.01, was paid on or before July 14, 1923, penalties would be inflicted upon the plaintiff and that the property of the plaintiff would be distrained and sold; and thereupon, to wit, on July 14, 1923, plaintiff paid the said sum under protest and in order to avoid the imposition of penalties and levy and distraint upon its property.

8. That thereafter, to wit, on March 18, 1924, a claim for refund was duly filed, as required by law, for the sum of $193,598.91, with interest, being the sum of $166,910.01 assessed and collected as aforesaid, and the sum of $26,668.90 assessed and credited as hereinbefore recited, against the aforesaid additional assessment of federal and income profit taxes for the years 1916 and 1917, and that thereafter, to wit, January 8, 1925, said Commissioner of Internal Revenue rejected and disallowed said claim for refund.

9. That during the years 1916 and 1917 plaintiff kept its accounts upon a basis other than that of actual receipts and disbursements, commonly known as an accrual basis.

10. That for the year 1916 the corporation income tax return, and for the year 1917 the corporation income tax return and excess profit tax return of plaintiff were made, returned and filed on the basis on which its accounts were kept as aforesaid, viz., an accrual basis.

[fol. 66] It is thereupon ordered and adjudged by the Court that in determining the taxable net income of the plaintiff for the year 1916, the deduction of munitions tax for that year in the sum of $246,275.63 was properly made and in conformity to law.

It is further ordered and adjudged by the Court that the defendant go hence without day and recover of the plaintiff his costs and disbursements herein expended taxed at $— and that said plaintiff pay its own costs. To which judgment the plaintiff, The Aluminum Castings Company, excepts. Said plaintiff excepts to the failure and refusal of the court to find the findings of fact Nos. 1 to 14, inclusive, and each of them, and each and every part thereof, requested by the plaintiff; and excepts to the special findings of fact Nos. 1 to 10, inclusive, and each of them, found by the court herein, and particularly to the special findings of fact Nos. 9 and 10, and each of them, found by the court herein, because said special findings of fact are contrary to the evidence and are not sustained by any evidence; and excepts to the conclusions of law Nos. 1 and 2, and each of them, made by the court herein, because said conclusions of law are not sustained by any evidence and are contrary to the evidence and the law; and excepts to the judgment herein because the facts found by the court are not sufficient to support said judgment; and excepts to the judgment herein because there is no evidence to support it and because said judgment is contrary to law.

Thereupon, to wit, on December 20, 1927, and within three (3) days after the entry of the judgment aforesaid, the plaintiff filed its written motion for a new trial, and to set aside said judgment as appears of record herein, which said motion was submitted to the court, and the court on consideration thereof overruled the same, to which action of the court the plaintiff duly excepted.

Now comes the plaintiff and presents to the court its bill of exceptions, in narrative form, taken on the trial of said cause; and the court, upon consideration thereof, finds the foregoing, and the exhibits attached hereto, to be a true, correct and complete bill of exceptions, and the same is hereby allowed and signed and ordered to be filed as a part of the record herein, 2nd day of February, 1928.

D. C. Westenhaver, Judge.

[fol. 67] PLAINTIFF'S EXHIBITS NOS. 1 AND 2

"Original" and "Amended" Corporations Return of Annual Net Income for the Year Ended December 31, 1916, with Letter Granting Extension of Time

(Filed Nov. 11, 1927)

United States of America, Treasury Department

April 12, 1927.

Pursuant to Section 882 of the Revised Statutes, I hereby certify that the annexed are true copies of "Original" and "Amended" Corporations Returns of Annual Net Income for the year ended December 31, 1916, (with letter granting extension of time, and letter dated March 31, 1917 attached to former return), filed by The Aluminum Castings Company, Cleveland, Ohio, on file in this Department.

In witness whereof I have hereunto set my hand, and caused the seal of the Treasury Department to be affixed, on the day and year first above written.

By direction of the Secretary.

Carl T. Schuneman, Assistant Secretary of the Treasury. (Seal.)

JRW. B.

[fol. 68] PLAINTIFF'S EXHIBIT NO. 1

Original Corporation Returns of Annual Net Income for the Year Ended December 31, 1916

(Filed Nov. 11, 1927)

Extension granted.
Return audited.
See Rev. Agts. report 7-17-17.
No add'l tax due E 8/7.
$1,719.01 refunded 3/8/18. W. H. H.

Form 1031

(Revised October, 1916)

Income Tax

The penalty for failure to have this return in the hands of the Collector of Internal Revenue within the time required by law is not more than $10,000 and the assessment is increased fifty per cent.

Return of Annual Net Income

(Title I, Parts II and III, of the Act of September 8, 1916)

To be filled in by Internal Revenue Bureau: Audited by 957 E. 8/7/17.

To be filled in by Collector: Collection District, 18th Ohio. Assessment List, 23-A, Page 2, Line 7. (Month:) Mar., 1917.

(18th Ohio, Mar. 31, 1917. Collr. Int. Rev.)

Above space to be stamped by Collector, showing district and date filed.

Important

Read this form and all instructions carefully and fill in supplementary statement before making entries in return proper. Totals in supplementary statement must agree with totals in return.

(I. T. S. A. Am. May 4, 1921, Received.)

Corporations

(Other Than Insurance Companies)

[fol. 69] Return of Net Income for the Calendar *Fiscal Year Ended December 31, 1916, by the Aluminum Castings Co., Foundry and Located at 6205 Carnegie Ave., Cleveland, Ohio

(The address given must be that of the principal place of business of the corporation.)

If no figures are to be extended opposite any item in the return, the word "None" should be inserted.

1. Total amount of paid-up capital stock outstanding at the close of the year, or if no capital stock, the capital, other than interest-bearing indebtedness, employed in the business at the close of the year	$400,000 00
2. Total amount of bonded and other interest-bearing indebtedness outstanding at close of year, exclusive of indebtedness wholly secured by collateral, the subject of sale or hypothecation in ordinary business of the corporation	None.

3. Gross income:	Dollars	Cts.
(a) From operations	$9,583,194.76	
(b) From rentals	1,602.50	
(c) From interest	18,991.41	
(d) From dividends received	None	
(e) From other sources	None	
Total gross income	$9,603,788.66	
Total deductions	4,306,764.25	
8. Net income	$5,297,024.41	
9. Tax assessable at 2%	$105,940.49	
10.		
Total		

Deductions	Dollars	Cts.
4. (a) Expenses, general	$4,182,726.75	
(b) Payments in lieu of rent	None	
5. (a) Losses sustained charged off	40,661.66	
(b) Depreciation charged off	56,882.40	
(c) Depletion charged off	None	
6. (a) Interest paid (see Note 6a)	None	
(b) Interest paid by banks on deposits	None	
7. (a) Taxes, domestic paid	26,493.44	
(b) Taxes, foreign paid	None	
Total deductions	$4,306,764.25	

We, W. P. King, Vice-President, and J. F. McCashen, Treasurer of the above-named company, whose return of net income is herein set forth, being severally duly sworn, each for himself, deposes and says that the items entered in the foregoing report and in the supplementary statement and in any additional list or lists attached to or accompanying this return are, to his best knowledge and belief, true and correct in each and every particular.

W. P. King, Vice-President. J. F. McCashen, Treasurer.

[fol. 70] Sworn to and subscribed before me this 28th day of March, 1917. W. E. Traster, Notary Public. (Seal.)

General Instructions

Time of Filing Returns.—Returns made on the basis of a calendar year must be filed on or before March 1 with the Collector of Internal Revenue of the district in which is located the principal place of business of the corporation; if made on the basis of a Fiscal Year* they must be filed within 60 days after the close of such year.

*Fiscal Year.—Corporations desiring to make returns of annual net income on the basis of a fiscal year other than the calendar year must, not less than 30 days prior to March 1 of the year in which the return would be due if made on the calendar year basis, file with the Collector a notice in writing designating the last day of some month as the close of such fiscal year. A return for that portion of the calendar year ending with the date designated as the close of the fiscal year must be filed on or before the first day of March of the next calendar year, and the return for each full fiscal year thereafter must be filed within 60 days after the closing date of the fiscal year so established.

Extension of Time.—In the case of neglect to file the return within the prescribed time, the Collector is authorized to grant an extension of the filing period not exceeding 30 days from the normal due date, provided such neglect was due to absence or sickness and provided an application for such extension is made in writing prior to the expiration of the period for which extension may be granted. In meritorious cases the Commissioner is au-

thorized to grant such further extension as he may deem proper.

Signatures and Verification.—Returns must be signed and verified by two officers of the corporation, that is, by the president, vice president, or other principal officer, and the treasurer or other financial officer, and must be sworn to before an officer authorized to administer oaths, and the seal of the attesting officer, if he is required to have a seal, must be impressed on the return in the space provided for that purpose.

Subsidiary Companies.—The corporation making this return should attach hereto a list of all its subsidiary companies, if any, with the location of the principal place [fol. 71] of business of each. Each subsidiary company must make a separate and distinct return.

Foreign Corporations.—Foreign corporations subject to the law are required to make returns to the Collector of the District in which is located the principal place of business or agency through which is transacted the business in the United States, or if the corporation has no place of business or agency in the United States, its return will be filed with the Collector of Internal Revenue at Baltimore, Maryland. The gross income to be returned is that received from business transacted and capital invested in the United States, including interest on bonds, notes, or other interest-bearing obligations of residents, corporate or otherwise, and including income derived from dividends on capital stock or from net earnings of resident corporations, joint-stock companies, or associations whose net income is taxable under this law. The deductions allowable are those losses and disbursements incident and necessary to the transaction of the business in this country, all as specifically set out in the Act. Foreign taxes are not deductible from the gross income arising and accruing to a foreign corporation from business done or capital invested in the United States. In the case of a foreign corporation having no place of business or agency in the United States and no return is made, the tax on income from interest and dividends will be withheld at the source.

Penalties.—Corporations refusing or neglecting to file returns within the time prescribed by law or rendering false or fraudulent returns shall be liable to a penalty of not exceeding $10,000, and an additional tax of 50 per cent

in case of neglect to file the return within the time prescribed by law, and 100 per cent in the case of a false or fraudulent return shall be added to the assessment; provided in case of delinquency, if the return is voluntarily filed without notice from the Collector, and it is shown that delay in filing was due to reasonable cause and not to willful neglect, the 50 per cent additional tax will not be assessed.

Any officer of any corporation required by law to make, render, sign, or verify any return, who makes any false or fraudulent return or statement with intent to defeat or evade the assessment required to be made shall be guilty of a misdemeanor, and shall be fined not exceeding $2,000 or be imprisoned not exceeding one year, or both, at the discretion of the court, with the costs of prosecution.

[fol. 72] Supplementary Statement

The following information must be furnished by every corporation, joint-stock company, or association, without which the return will not be accepted as complete. The items herein relate to the items listed in the above return form and bear corresponding numbers, and the total set out in the above return must agree with the totals hereinafter set out.

1. Paid-up Capital Stock:

Unissued or treasury stock should not be included in this item, but only such stock as has been actually issued and is outstanding at the close of the year and for which payment has been received. Where the stock issued is payable in installments or assessments, only so much of it as has been actually paid in upon such installments or assessments should be reported.

If no capital stock is issued or if the capital stock is issued without par value, the amount of capital invested in the business at the close of the year, not including borrowed capital, will be entered under this Item.

(a) Paid-up "common stock"	$400,000 00
(b) Paid-up "preferred stock"	None.
Total paid-up stock	$400,000 00
or (c) Capital employed in business	$ .....

2. Indebtedness:

All interest-bearing indebtedness, for the payment of which the corporation or its property is bound, should be reported below. In the case of banking corporations and like financial institutions, deposits should not be reported as indebtedness. Indebtedness wholly secured by collateral, the subject of sale or hypothecation in the ordinary business of the corporation, should be reported here, but such indebtedness must not be entered under Item 2 above nor be considered in determining the amount of interest deductible under Item 6 (a).

Character of obligation	Rate of interest	Principal
None.	.....	None.

A 1.

[fol. 73] 3. Gross Income:

All manufacturing, mercantile, or other corporations which determine their annual gain or loss by inventory are required to state the same in the form indicated below. If the annual income or loss is determined otherwise, the methods employed must be stated in the space provided therefor. In case the annual gain or loss is determined by inventory, merchandise must be inventoried at the cost price, as any loss in salable value will ultimately be reflected in the sales during the year when the goods are disposed of.

(a) From Operations:

Per inventory—		
Sales during year	$19,070,992.85	
Stock on hand at close of year	1,345,849.27	
Total		$20,416,842.12
Purchases during year	$10,294,914.42	
Stock on hand at beginning of year	538,732.94	
Total		$10,833,647.36
*Total gain or loss [3 (a), first page]		$9,583,194.76

In the case of manufacturing corporations, "Purchases during the year" will include so much of the cost of goods, finished or unfinished, sold or unsold, as has not been separately deducted under any item of the return.

Overhead charges should not be included in inventory (see Item 4).

*(If inventory shows loss, make entry in red ink or strike out "gain.")

If inventory is not used, state below method of determining gain or loss from operations:

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In case of the sale of capital assets acquired prior to March 1, 1913, the profit or income to be returned will be the difference between the fair market value of such assets as of March 1, 1913, and the price at which they are sold. If acquired subsequent to March 1, 1913, then the profit or income to be returned is the difference between the cost and the selling price.

[fol. 74] In the case of the sale of assets acquired prior to March 1, 1913, state—

(1) Original cost of assets ..... $.....
(2) Fair market price or value as of March 1, 1913 .....
(3) Price at which assets were sold ....

State how fair market price or value as of March 1, 1913, was determined:

(b) From Rentals:

$1,602.50.

Rentals to be reported as income will include all payments received in cash or its equivalent as rent on buildings or other property owned by the corporation making the return, as well as all royalties received.

(c) From Interest:

Interest to be reported as income includes all interest received on bonds or securities owned by the corporation with the exception of interest on obligations of a State or political subdivision thereof or interest upon the obligations of the United States or its possessions, which latter

interest for the purpose of information should be extended below:

U. S., State, and Other Obligations

Name of obligation	Amount of principal	Rate	Amount of interest received
Bank Accounts.	Varying amounts.	2% or 3%.	$18,991 41.

(d) From Dividends Received:

None.

Any distribution made or ordered to be made by a corporation out of its earnings or profits accrued since March 1, 1913, whether in cash or stock of the paying company must be returned by the receiving corporation as income of the year in which the distribution was made or ordered to be made. Stock dividends must be returned to the amount of their cash value and such cash value is held to be the proportionate share of the surplus accrued to the paying corporation since March 1, 1913, as is represented by the stock distributed or ordered to be distributed to the receiving corporation.

[fol. 75] (e) From Other Sources:

None.

All other sources from which income has been received, and the amount thereof, should be itemized below:

None. None.

4. Expenses, General:

This item should include only the ordinary and necessary expenses paid within the year in the maintenance and operation of the business and properties of the corporation, itemized as per schedule below, and will not include any disbursements the deduction of which is specially provided for in the return form proper on the obverse side of this form.

Interest paid on indebtedness wholly secured by property collateral the subject of sale or hypothecation in the ordinary business of the corporation as a dealer only in

the property constituting such collateral or in the loaning of funds thereby produced, is an allowable deduction as a business expense to an amount of the interest paid on such indebtedness not in excess of the actual value of the collateral securing it.

All expenses of material, labor, fuel, and other items entering into the cost of goods purchased, sold, or inventoried are deductible under this head as expense, provided such items have not been considered in determining the cost or purchases during the year when the income derived from operations is ascertained through an inventory as set out in Item 3 (a) of this statement.

Expenditures for incidental repairs which do not add to the value or appreciably prolong the life of property are deductible as expenses, but expenditures for new buildings, permanent improvements or betterments which increase the value of property, or for restoring or replacing property, are not deductible under this or any other item of the return. Such expenditures are properly chargeable to capital account, to be extinguished through annual depreciation allowances.

Payments made to officers or employees who are stockholders, which payments are made in the guise of salaries or compensation and the amount of which is based upon the stockholdings of such officers or employees, are not de- [fol. 76] ductible as a business expense.

(a) 1.	Labor, wages, commissions, etc	$2,410,246 24
2.	Fuel, light, power, etc	193,223 50
3.	Rentals (ordinary)	None
4.	Repairs, ordinary and incidental	89,139 51
5.	Interest on indebtedness wholly secured by collateral the subject of sale, etc.	None
6.	Salaries of officers	55,200 00
7.	Other expenditures—Classify:	
	Commissions	49,217 97
	Gen. Overhead	135,062 23
	Sup. Misel. Office & Plant also Selling expense	1,250,637 30
	Total expenses	$4,182,726 75

4. (a) 8. Names of officers and employees to whom salaries of $3,000 or more were paid during the year and amount paid to each. (If the space below is not adequate a list marked "Item 4 (a)" containing this information should be attached to this form.)

Name	Address	Amount
List attached.	. . . . .	. . . . .

Corporations paying to individuals salaries or rentals in excess of $3,000 per year are required to withhold the normal tax of 2 per cent (1 per cent for 1916) on the entire amount so paid, unless certificates of exemption are filed, in which case the tax must be withheld on the amount in excess of the exemption claimed. The tax so withhold must be returned on Form 1042, which, together with all certificates of exemption, must be filed in the Collector's office not later than March 1.

Notwithstanding the withholding of the tax, the individual receiving income from this and all other sources of $3,000 or more must also make returns on Form 1040.

(b) Payments in Lieu of Rent:

This item should include all royalties and other charges, including any interest payments which the corporation is required to make for the right to use and possess property in which it has no title, interest, or equity. See Note [fol. 77] 6 (a).

5. (a) Losses:

Losses deductible under this item must be distinguished from depreciation or allowances for exhaustion, wear and tear. The losses must be absolute, complete, actually sustained during the year and charged off on the books of the corporation, and if the losses result from the sale of assets acquired prior to March 1, 1913, such losses shall be ascertained by taking the difference between the fair market price or value as of March 1, 1913, and the selling price.

Losses compensated by insurance or otherwise are not deductible.

Kind of asset	Original amount	Date charged off	Amount charged off
Bad Accounts.....	$9,712.75	Various dates in 1916.....	$9,712.75
Plant	55,948.71	June 30, 1916.....	30,948.91
Total			$40,661.66

When were the deducted losses ascertained to be such? Plant Loss 6/30/16 and accounts lost at various dates.

How were they so ascertained? Account losses by repeated failure in attempts to collect & Plant loss by sale of plant.

In case of losses resulting from the sale of capital assets acquired prior to March 1, 1913, state--

(1) Original cost of assets Acquired prior to Mar. 1, 1913	$54,019 45
(2) Fair market price or value as of March 1, 1913	53,000 00
(3) Loss resulting from such sale	30,948.91

State also how the fair market price or value as of March 1, 1913, was ascertained: By cost less depreciation.

(b) Depreciation:

The amount deductible on account of depreciation is an amount charged off which fairly measures the loss during the year in the value of physical property by reason of exhaustion, wear and tear. Such amount should be determined upon the basis of the cost of the property and the probable number of years constituting its life. Stocks, [fol. 78] bonds, and like securities, as well as any other intangible assets, are not subject to exhaustion, wear and tear within the meaning of the law. Hence any amount charged off as representing a shrinkage in the value of such assets is not deductible either as depreciation or loss.

Depreciation computed on total invoice value of merchandise in stock is not an allowable deduction, since any loss due to the shrinkage in the salable value of the merchandise will be reflected in the sales when the merchandise is disposed of.

Kind of property	Its cost	Probable life after acquirement	Amount of depreciation	
			This year	Previous years
Buildings	$616,738.82	40 years	$10,707.50	$7,855.00
Equipment	646,023.83	15 years	46,174.90	40,577.00
Totals			$56,882.40	$48,432.00

If buildings, state kind of construction.

(c) Depletion:

Depletion applies to the exhaustion of natural deposits, and contemplates a deduction to return to the corporation the capital invested, or in case of purchase prior to March 1, 1913, an amount sufficient to return to the corporation the fair market value of such deposits as of that date. An allowable deduction on account of depletion must not exceed the fair market value in the mine of the product thereof mined and sold during the year, and in case of oil or gas wells the amount deductible should be computed upon the basis of the decline in the settled flow. The amount sought to be deducted on this account must be charged off on the books of the company.

*Kind of property	Its cost if acquired subsequent to March 1, 1913	†Fair market value as of March 1, 1913	Amount of depletion	
			This year	All years to date
None.	None.	.....	.....	.....

*Coal, iron ore, copper, oil, or gas.
†State how far market value as of March 1, 1913, was determined.

[fol. 79] 6. (a) Interest Deductible:

The amount of interest deductible under this item is the amount actually paid within the year on an amount of bonded or other indebtedness not in excess of the paid-up capital stock outstanding at the close of the year, or if no capital stock, the entire amount of capital (not including interest-bearing indebtedness) employed in the business at the close of the year, plus, in each case, one-half of the interest-bearing indebtedness also then outstanding.

Capital employed in the business, as here used, contemplates the entire capital paid in by the members of the com-

pany, including so much of the accumulated surplus as is not in excess of the needs of the business, but does not include any borrowed capital or interest-bearing indebtedness.

Interest, so-called, or dividends paid upon preferred capital stock, is not deductible.

Interest deductible under this item includes all interest actually paid within the year not in excess of the limit hereinbefore indicated on any debt for which the corporation or any property in which it has title, interest, or equity is pledged, except interest on indebtedness wholly secured by collateral the subject of sale or hypothecation in the ordinary business of the company, etc., which interest is deductible under Item 4 (a) as a business expense.

Interest Payments Actually Made During Year

All forms of indebtedness upon which interest was paid should be listed here.

Name or kind of obligation	Amount of principal	Rate of interest	Amount of interest paid
.....	.....	.....	.....
.....	.....	.....	.....

(b) Interest Paid on Deposits:

Interest paid (by banks) on deposits or on money received for investment and secured by interest-bearing certificates of indebtedness issued by a bank, banking association, loan or trust company is deductible in the entire [fol. 80] amount so paid.

7. (a) Taxes—Federal, State, etc $26,493 44
(b) Taxes—Foreign ....

Taxes deductible under these items are such taxes as are imposed by the United States, by any State or Territory, or by any political subdivision thereof, or by the Government of any foreign country, and are actually paid or accrued on the books of the corporation, not in excess of the amount due and payable within the year for which the return is made, except that taxes imposed under the laws of a foreign Government are not deductible from the income arising and accruing to a foreign corporation by

reason of the business transacted or capital invested in this country, and except that taxes paid for local benefits or taxes paid by corporations pursuant to covenants guaranteeing their bonds to be tax-free are not deductible.

Taxes paid by banks or other corporations on the value of their capital stock outstanding and in the hands of stockholders are not deductible. Such taxes are a primary liability of the stockholders, as such chargeable against their income.

State whether or not this return is made on the basis of actual receipts and disbursements. Yes.

If not, describe fully what other basis or method was used in computing net income.

.....

.....

Where sufficient space is not provided for the entry of the information required in the "Supplementary Statement," lists containing full information in the form indicated should be marked in accordance with the particular item and attached to this form.

A2

[fol. 81] Treasury Department, Internal Revenue Service

(Seal)

(U. S. Int. Rev., Corporation Income Tax Division, Apr. 5, 1917)

Office of the Collector, 18th District of Ohio

Feb. 27, 1917.

Aluminum Castings Co., Cleveland, Ohio:

In response to your request of Feb. 27, 1917, there is hereby granted an extension of thirty (30) days from March 1, 1917, in which to file your return of munitions tax [annual net income]* for the year ended Dec. 31, 1916.

[*Words enclosed in brackets erased in copy.]

In order that you may receive the benefit of this extension, it is essential that this letter be attached to your return when filed in this office.

Respectfully, Harry H. Weiss, Collector.

A5

[fol. 82] PLAINTIFF'S EXHIBIT NO. 2

Amended Corporation Return of Annual Net Income for the Year Ended December 31, 1916

(Filed Nov. 11, 1927)

[Allow $1,719.01 Refunded]*
[Feb. 19, 1918. W. H. H.]*

Return Audited
Amended

Form 1031

(Revised October, 1916)

Income Tax

The Penalty for failure to have this return in the hands of the Collector of Internal Revenue, within the time required by law is not more than $10,000 and the assessment is increased fifty per cent.

Return of Annual Net Income

(Title I, Parts II and III, of the Act of September 8, 1916)

To be filled in by Internal Revenue Bureau: Audited by —— ——.

957X

Amended

Above space to be stamped by Collector, showing district and date filed.

To be filled in by collector: Collection District: 18 Ohio. Assessment List: 23-A, —— —, 191-, Page —, Line —.

[*Words and figures enclosed in brackets erased in copy.]

Important

Read this form and all instructions carefully and fill in supplementary statement before making entries in return proper. Totals in supplementary statement must agree with totals in return.

Corporations

(Other Than Insurance Companies)

[fol. 83] Return of Net Income for the Calendar [Fiscal]* Year Ended December 31, 1916, by the Aluminum Castings Company and Located at 6205 Carnegie Avenue, Cleveland, Ohio

(The address given must be that of the principal place of business of the corporation.)

If no figures are to be extended opposite any item in the return, the word "None" should be inserted.

1. Total amount of paid-up capital stock outstanding at the close of the year, or if no capital stock, the capital, other than interest-bearing indebtedness, employed in the business at the close of the year	$400,000 00
2. Total amount of bonded and other interest-bearing indebtedness outstanding at close of year, exclusive of indebtedness wholly secured by collateral, the subject of sale or hypothecation in ordinary business of the corporation	None

[*Word enclosed in brackets erased in copy.]

3. Gross income:	Dollars	Cts.
(a) From operations	$9,512,048.36	
(b) From rentals	.....	
(c) From interest	.....	
(d) From dividends received	.....	
(e) From other sources	.....	
Total gross income	$9,512,048.36	
Total deductions	4,300,974.25	
8. Net income	$5,211,074.11	
9. Tax assessable at 2%	$104,221.48	
10.	.....	
Total	$.....	

Deductions	Dollars	Cts.
4. (a) Expenses, general	$4,132,604.08	
(b) Payments in lieu of rent	.....	
5. (a) Losses sustained charged off	34,871.66	
(b) Depreciation charged off	107,005.07	
(c) Depletion charged off	.....	
6. (a) Interest paid (see Note 6a)	.....	
(b) Interest paid by banks on deposits	.....	
7. (a) Taxes, domestic paid	26,493.44	
(b) Taxes, foreign paid	.....	
Total deductions	$4,300,974.25	

S. H. P.

[fol. 84] We, W. E. Traster, Comptroller, [President,]* and J. F. McCashen, Treasurer, of the above-named company, whose return of net income is herein set forth, being severally duly sworn, each for himself, deposes and says that the items entered in the foregoing report and in the supplementary statement and in any additional list or lists attached to or accompanying this return are, to his best knowledge and belief, true and correct in each and every particular.

W. E. Traster, [President.]* Comptroller. J. F. McCashen, Treasurer.

Sworn to and subscribed before me this 12th day of July, 1917. Arthur G. Roethe, (Official Capacity:) Dep. Coll. (Seal of officer taking affidavit.)

Printer's Note.—The paragraphs in this Return under the captions "General Instructions" and "Supplementary Statement," having no insertions and being exactly the same as in Plaintiff's Exhibit No. 1 in form, have been omitted. See pages 70 and 72 hereof.

[fol. 85] PLAINTIFF'S EXHIBITS NOS. 3 AND 4

Corporation Income and Corporation Excess Profits Tax Returns for 1917, with Balance Sheets and Statement Attached to Latter Return, Executed March 28, 1918

(Filed Nov. 11, 1927)

UNITED STATES OF AMERICA,

(Seal)

Treasury Department

April 12, 1927.

Pursuant to Section 882 of the Revised Statutes, I hereby certify that the annexed are true copies of Corporation Income and Corporation Excess Profits Tax Returns for 1917, (with balance sheets, and statements attached to latter return), executed March 28, 1918, filed by The Aluminum

[*Words enclosed in brackets erased in copy.]

Castings Company, Cleveland, Ohio, on file in this Department.

In witness whereof, I have hereunto set my hand, and caused the seal of the Treasury Department to be affixed, on the day and year first above written.

By direction of the Secretary.

Carl T. Schuneman, Carl T. Schuneman, Assistant Secretary of the Treasury. (Seal.)

Treasury Department, Chief Clerk and Superintendent.

Form 66.

J. R. W.

[fol. 86] PLAINTIFF'S EXHIBIT NO. 3

Corporation Income Tax Return for the Year 1917

(Filed Nov. 11, 1927)

Return Audited

(I. T. S. A. Am., May 8, 1922.)
(I. T. S. A. Am., May 4, 1921, Received.)
23750907. 406.

Form 1031 (Revised January, 1918.)—United States Internal Revenue

Corporation Income Tax Return

(For All Corporations Except Railroad and Insurance Companies)

Return of Annual Net Income for the Calendar Year 1917 [Fiscal Year Ended —— —, 19—.]*

"B"

(Do not write in this space:) Received —— —, ——. List —, Month —, Page —, Line —. Audited by —— ——.

Name of corporation: The Aluminum Castings Company. Principal office: 6205 Carnegie Avenue, Cleveland, Ohio. Kind of business carried on: Manufacturing of Aluminum, Brass & Bronze Casting. Date of organization: August 13, 1909.

[*Words and figures enclosed in brackets erased in copy.]

[fols. 87 & 88]

1. Total amount of paid-up capital stock outstanding at the close of the year, or if there is no capital stock the capital other than interest-bearing indebtedness employed in the business at the close of the year. Unissued or treasury stock must not be included in this item, but only stock actually issued and outstanding at the close of the year for which this return is made.
2. Total amount of bonded or other interest-bearing indebtedness outstanding at the close of the year, exclusive of indebtedness wholly secured by collateral the subject of sale or hypothecation in the ordinary business of the company and exclusive also of indebtedness incurred in the purchase of securities, the income from which is not subject to income tax.

(a) Paid-up "common stock"	$400,000.00
(b) Paid-up "preferred stock"	None
Total paid-up stock	$400,000.00
or (c) Capital employed in business	

Character of obligation	Rate of interest	Principal
None		$
Total indebtedness		$

Income

3. (a) Gross sales and other income from operations	$18,679,704.16
(b) Income from rentals, royalties, etc	
(c) Income from interest (see item 3c on back of return)	16,742.57
(d) Income from dividends (see item 3d on back of return)	
(e) Income from all other sources (see item 3e on back)	
Total gross sales and other income	18,696,446.73
Less total deductions	17,283,304.91
8. Total net income	1,413,141.82

Deductions

(See corresponding items on back of return)

4. (a) Cost of goods and other property sold	$15,358,391.84
(b) Expenses, general	1,432,793.72
5. (a) Losses sustained charged off	118,106.37
(b) Depreciation charged off	78,194.00
(c) Depletion charged off	
6. (a) Interest paid (except as entered under 6b and c	
(b) Interest paid on deposits (for banks only)	
(c) Interest paid on indebtedness wholly secured by collateral	
7. (a) Domestic taxes paid, not including income and excess profits taxes	295,818.98

Less:

(a) Excess profits tax (item 12)	$411,102.63	
(b) Dividends received out of earnings of 1913, 1914, 1915	.....	
Total (a plus b)		411,102.63
9. (a) Amount taxable at 2% (item 8 less total of a plus b)		1,002,039.19
(b) Amount taxable at 1% (item 8b)		.....
10. Amount of total net income shown in item 8		1,413,141.82

Less:

(a) Excess profits tax (item 12)	$411,102.63	
(b) Dividends received (item 3d)	.....	
Total (a plus b)		411,102.63
11. Amount taxable at 4% (item 10 less total of a plus b)		1,002,039.19
If return is made for a full fiscal year ended in 1917, compute tax on as many twelfths of item 11 as there are months from January 1, 1917, to the close of the fiscal year. Enter amount taxable here		.....

(b) Foreign taxes paid		.....
Total deductions		17,283,304.91

Tax

12. Amount of excess profits tax (see instructions below)		411,102.63
13. Amount of 2% tax (2% of item 9a)		20,040.79
14. Amount of 1% tax (1% of item 9b)		.....
15. Amount of 4% tax (4% of item 11)		40,891.57
16. Total tax assessable	471,225.00	471,234.99

[fol. 89] NOTE.—Stamped on face of Return:

(Not consolidated 1917-8-[9]*, Year; Consolidated returns Subdivision, W. T. Rogers, Auditor. Approved: J. A. C., L., Chief of Subdivision.)

(Additional Tax $188,893.83; Penalty; Credit: 1916, 5790.32; 1918, 34,739.06; 191-; Balance taxable, $148.364.45; Basis, Field Audit I. T. S. A. Am., H. J.; Date, Jun. 1921; Page.)

(957.)

(D. W. O.)

(471225.00.)

(Audited: Tax liability increased; Penalty; Tax liability reduced; Claim rejected for $148,364.45; Claim control number 237,157; Basis (F. A.); Audited by I. T. S. A.: Am.; Unit No.; Date 4/25/23; Signed C. C. M. D.; Page; Line.)

We, the undersigned, president and treasurer of the above-named company, whose return of net income is herein set forth, being severally duly sworn, each for himself, deposes and says that the items entered in the foregoing report and in the supplementary statement and in any additional list or lists attached to or accompanying this return are, to his best knowledge and belief, true and correct in each and every particular.

E. E. Allyne, President. J. F. McCashen, Treasurer.

Sworn to and subscribed before me this 28 day of March 1918. W. E. Traster, (Official capacity) Notary Public. (Seal.) (Seal of officer taking affidavit.)

General Instructions

Excess Profits Tax.—For the purpose of war excess profits tax, every corporation subject to income tax shall be deemed to be engaged in business, and all the trades and businesses in which it is engaged (whether continuously carried on or not) shall be treated as a single trade or business, and all its income from whatever source derived shall [fol. 90] be deemed to be received from such trade or business.

[*Figure enclosed in brackets erased in copy.]

In the case of a trade or business having no invested capital or not more than a nominal capital, the excess profits tax is equivalent to 8 per cent of the net income in excess of $3,000. This tax applies primarily to corporations engaged principally in rendering personal service in which the employment of capital is not necessary and the earnings of which are to be ascribed primarily to the activities of the owners.

In the case of a trade or business having more than a nominal invested capital, the excess profits tax is equal to various percentages of the net income, depending on its ratio to the invested capital. Every corporation having a net income of over $3,000 for the taxable year must make a return of invested capital and compute the amount of tax on Form 1103.

For further instructions see Regulations No. 41, Relative to the War Excess Profits Tax. A copy can be obtained from any collector of internal revenue.

Time of Filing Returns.—Returns made on the basis of a calendar year must be filed on or before March 1 with the collector of internal revenue of the district in which is located the principal place of business of the corporation; if made on the basis of a fiscal year*, they must be filed within 60 days after the close of such year.

*Fiscal Year.—Corporations desiring to make returns of annual net income on the basis of a fiscal year other than the calendar year must, not less than 30 days prior to March 1 of the year in which the return would be due if made on the calendar year basis, file with the collector a notice in writing designating the last day of some month as the close of such fiscal year. A return for that portion of the calendar year ending with the date designated as the close of the fiscal year must be filed on or before the first day of March of the next calendar year, and the return for each full fiscal year thereafter must be filed within 60 days after the closing date of the fiscal year so established.

Extension of Time.—In the case of neglect to file the return within the prescribed time, the collector is authorized to grant an extension of the filing period not exceeding 30 days from the normal due date, provided such neglect was due to absence or sickness and provided an application for such extension is made in writing prior to the expiration of the period for which extension may be granted.

[fol. 91] In meritorious cases the Commissioner is authorized to grant such further extension as he may deem proper.

Signatures and Verification.—Returns must be signed and verified by two officers of the corporation, that is, by the president, vice president, or other principal officer, and the treasurer or other financial officer, and must be sworn to before an officer authorized to administer oaths, and the seal of the attesting officer, if he is required to have a seal, must be impressed on the return in the space provided for that purpose.

Subsidiary Companies.—The corporation making this return must attach hereto a list of all its subsidiary companies, if any, with the location of the principal place of business of each. Each subsidiary company must make a separate and distinct return.

Foreign Corporations.—Foreign corporations subject to the law are required to make returns to the collector of the district in which is located the principal place of business or agency through which is transacted the business in the United States, or if the corporation has no place of business or agency in the United States, its return will be filed with the collector of internal revenue at Baltimore, Maryland. The gross income to be returned is that received from business transacted and capital invested in the United States, including interest on bonds, notes, or other interest-bearing obligations of residents, corporate or otherwise, and including income derived from dividends on capital stock or from net earnings of resident corporations, joint-stock companies, or associations whose net income is taxable under this law. The deductions allowable are those losses and disbursements incident and necessary to the transaction of the business in this country, all as specifically set out in the Act. Foreign taxes are not deductible from the gross income arising and accruing to a foreign corporation from business done or capital invested in the United States. If a foreign corporation has no place of business or agency in the United States and no return is made, the tax on income from interest and dividends will be withheld at the source.

Penalties.—Corporations refusing or neglecting to file returns within the time prescribed by law or rendering false or fraudulent returns shall be liable to a penalty of

not exceeding $10,000, and an additional tax of 50 per cent in case of neglect to file the return within the time prescribed by law, and 100 per cent in the case of a false or [fol. 92] fraudulent return, shall be added to the assessment; provided, in case of delinquency, if the return is voluntarily filed without notice from the collector, and it is shown that delay in filing was due to reasonable cause and not to wilful neglect, the 50 per cent additional tax will not be assessed. A statement of the cause of delay must be attached to each delayed return.

Any officer or any corporation required by law to make, render, sign, or verify any return who makes any false or fraudulent return or statement with intent to defeat or evade the assessment required to be made shall be guilty of a misdemeanor, and shall be fined not exceeding $2,000 or be imprisoned not exceeding one year, or both, at the discretion of the court, with the costs of prosecution.

957 b 1

Supplementary Statement

3. (c) From Interest:

None.

Interest to be reported as income for the purpose of the income tax includes all interest received on bonds or securities owned by the corporation except interest on obligations of a State or political subdivision thereof or interest upon the obligations of the United States or its possessions.

3. (d) From Dividends Received:

None.

Any distribution made or ordered to be made by a corporation out of its earnings or profits accrued since March 1, 1913, whether in cash or stock of the paying company, must be returned (under Item 3 (d) on front page of this form) by the receiving corporation as income of the year in which the distribution was made or ordered to be made and will be taxed at the rates prescribed by law for the years in which surplus or profits distributed were earned, viz., 1% on amounts received out of earnings of 1913 (subsequent to March 1, 1913), 1914, and 1915, and 2% on amounts received from earnings of 1916 and 1917. A statement from the corporation paying the dividends included herein should be attached to this return, showing separately

the amount of dividends paid out of earnings of each year; otherwise, they will be deemed to have been paid out of the earnings of 1917 and will be taxed 2%. The receiving corporation, in order that tax may be computed on dividends received in 1917 at the rates applicable to the years [fol. 93] in which the profits were earned, must fill in the following form:

Dividends Received in 1917 Out of Profits Earned Each Year Subsequent to March 1, 1913

1913	1914	1915	1916	1917	Total
$					

3. (e) From Other Sources:
None.

Income received from all sources not elsewhere specified should be itemized below:

.....

.....

4. (a) Cost of Goods and Other Property Sold:

Report the cost of goods sold in the following form:

Merchandise bought for sale	$11,203,593 35
Cost of manufacturing or otherwise producing goods (if separately shown on books). Submit schedule showing principal items of cost	4,325,159 10
Plus inventories at beginning of year	1,149,256 38
Total	$16,678,008 83
Less inventories at end of year	1,319,616 99
Net cost of goods sold	$15,358,391 84

Explanations: Inventories were taken at cost.

If the corporation makes inventories of merchandise or materials, explain the basis on which they are made, whether (a) at cost, or (b) at cost or market value, whichever is (Balance of paragraph obliterated).

4. Depreciation and depletion to date of sale ... $ .....
5. Net cost (item 1 or item 2 plus item 3 minus item 4) .....

State how market value March 1, 1913, was determined. ——.

Does such value include any good will? If so, how much? $——.

[fol. 94] 4. (b) Expenses, General:

This item should include only the ordinary and necessary expenses paid within the year in the operation of the business and maintenance of the properties of the corporation itemized as per schedule below. It must not include any expenditures reported under 4 (a), 5, 6, or 7.

Expenditures for incidental repairs which do not add to the value or appreciably prolong the life of property are deductible as expenses, but expenditures for new buildings, permanent improvements or betterments which increase the value of property, or for restoring or replacing property, are not deductible under this or any other item of the return. Such expenditures are properly chargeable to capital account, to be extinguished through annual depreciation charges.

Payments made to officers or employees, who are stockholders, in the guise of salaries or compensation, the amount of which is based upon the stockholdings of such officers or employees, are not deductible as a business expense.

1. Salaries of officers	$158,466 15
2. Labor, wages, commissions, etc. (not included in "Cost of manufacturing or otherwise producing goods" under 4 (a))	.....
3. Rents, royalties, and other payments in lieu of rent	.....
4. Repairs, ordinary and incidental & maintenance	121,083 77
5. Other expenditures (classify):	
Traveling expense	23,371 55
General overhead	268,964 35
Advertising	57,565 27
Miscellaneous	803,342 63
Total expenses	$1,432,793 72

If salaries were increased or extra compensation was paid to officers, state the amount, the reason therefor, and the basis on which computed: President, Vice Pres., & Gen. Mgr. paid 4%, 3% and 1½% of net profits extra compensation for hard and successful work and efforts.

[fol. 95] 5. (a) Losses:

Losses deductible under this item must be distinguished from depreciation or allowances for exhaustion, wear, and tear. The losses, not compensated by insurance or otherwise, must be absolute, complete, actually sustained during the year, and charged off on the books of the corporation.

Kind of property on which loss is claimed	Cost of property	Cause of loss	Amount charged off within year
Bad Accts.....	$22,893.85	Uncollectable.....	$22,893.85
Allyne Brass Fdy. Stock.....	95,212.52	Business failed.....	95,212.52
Total			$118.106.37,

When were the deducted losses ascertained to be such? In 1917.

How were they so ascertained? By liquidating The Allyne (Balance torn off).

The cost of property lost should be determined as indicated in item 4 (a).

A bad debt offsetting income accrued since January 1, 1909, will not be allowed as a deduction unless the amount was reported as income for the year in which the debt was created.

State how the debts charged off (if any) were ascertained to be worthless. By repeated fruitless attempts to collect.

If at any future time a debt charged off as worthless is collected the amount collected must be returned as income for the year in which received.

Unpaid debts are not deductible if made good by recovery of property sold or retention of property pledged.

5. (b) Depreciation:

The amount deductible on account of depreciation is an amount charged off which fairly measures the loss during the year in the value of physical property by reason of

exhaustion, wear, and tear. Such amount should be determined upon the basis of the cost of the property and the probable number of years costituting its life. Stocks, bonds, and like securities, as well as any other intangible assets, are not subject to exhaustion, wear, and tear within [fol. 96] the meaning of the law. Hence any amount charged off as representing a shrinkage in the value of such assets is not deductible either as depreciation or as a loss.

Depreciation computed on total invoice value of merchandise in stock is not an allowable deduction by reason of damage or obsolescence the merchandise is unsalable.

If a deduction is made on account of depreciation, the following statement must be filled in:

Kind of property	Its cost	Probable life after acquirement	Amount of depreciation charged off	
			This year	Previous years
Buildings	$745,077.47	50 years	$9,948.00	$10,707.50
Equipment	1,020,684.48	10 years	68,246.00	46,174.90

If building, state under "Kind of property" the material of which constructed.

5. Depletion.

None.

Depletion applies to the exhaustion of natural deposits, and contemplates a deduction to return to the corporation the capital invested, or in case of purchase prior to March 1, 1913, an amount sufficient to return to the corporation the fair market price or value of such deposits as of that date. An allowable deduction on account of depletion must not exceed the fair market value as of March 1, 1913, or the cost subsequent to that date, of the product mined and sold during the year, and will be determined in accordance with the rule set out in Articles 170 to 173, Regulations 33, Revised. The amount sought to be deducted on this account must be charged off on the books of the company.

*Kind of of property	Its cost if acquired subsequent to March 1, 1913	†Fair market value as of March 1, 1913	Amount of depletion charged off	
			This year	Previous years
.....	.....	.....	.....	.....

*Coal, iron ore, copper, oil, or gas.

†State how fair market value as of March 1, 1913, was determined.

——.

6. Interest Paid:

(a) The amount of interest deductible under (a) is the amount — the year on an amount of bonded or other indebtedness (except on indebtedness falling under 6 (b) or 6 (c) and indebtedness incurred for the purchase of obli- [fol. 97] gations or securities the income from which is exempt from income tax) not in excess of the paid-up capital stock outstanding at the close of the year, or if there is no capital stock, the entire amount of capital (not including interest-bearing indebtedness) employed in the business at the close of the year, plus, in each case, one-half of the interest-bearing indebtedness also then outstanding.

Capital employed in the business, as here used, contemplates the entire capital paid in by the members of the company, including so much of the accumulated surplus as is actually employed in the business, but does not include any borrowed capital or interest-bearing indebtedness.

(b) Interest paid (by banks) on deposits or on money received for investment and secured by interest-bearing certificates of indebtedness issued by a bank, banking association, or loan or trust company is deductible in the entire amount so paid.

(c) If the corporation's indebtedness, or any part thereof, is wholly secured by collateral which is the subject of sale or hypothecation in the corporation's ordinary business as a dealer in such property, the interest paid on an amount of such indebtedness not exceeding the actual value of the collateral may be deducted.

Describe all obligations on which interest is paid in the following form. Distinguish plainly collateral loans falling under 6 (c) and also obligations incurred for the purchase of securities, the income from which is exempt from income tax.

Kind of obligation	Amount of principal	Rate of interest	Amount of interest paid
.....	.....	.....	.....
.....	.....	.....	.....

7. (a) Taxes Paid:

Taxes, paid or accrued on the books of the corporation during the taxable year, are deductible with the following

exceptions: Federal income and excess profits taxes (including taxes paid on the interest on its own obligations in pursuance of a covenant contained therein relieving the holder of liability for such taxes), foreign taxes on income derived from sources within the United States by foreign corporations, local taxes specially assessed against prop- [fol. 98] erty on account of benefits derived from public improvements or betterments, and taxes upon the corporation's capital stock in the hands of the stockholders.

Basis of Return:

Is this return made on the basis of actual receipts and disbursements? Yes, except as below indicated.

If not, describe fully what other basis or method was used in computing net income. Bills and Accounts Payable & Receivable are treated as receipts and disbursements.

Undistributed Income, Surplus, and Undivided Profits

Total net income of taxable year preceding that for which this return is made (less income tax paid thereon)	$5,176,186 19
Amount of such income remaining undistributed six months after the close of that year	3,060,286 32
Amount of such income remaining undistributed twelve months after the close of that year	3,060,286 32
Total surplus and undivided profits at close of taxable year	3,705,456 07

If sufficient space is not provided for the entry of any information required in the "Supplementary Statement," schedules in the form indicated, marked with the number of the item to be explained, should be attached to this form.

b 2

[fol. 99] PLAINTIFF'S EXHIBIT No. 4

Corporation Excess Profits Tax Return

(Filed Nov. 11, 1927)

Form 1103—United States Internal Revenue

Corporation Excess Profits Tax Return

Taxable Year Ended December 31, 1917

Caution

Read all instructions.
Answer all questions.
If necessary, ask your Collector of Internal Revenue for assistance.

(Do not write in this space:) Received —— —, ——. List —, Month —, Page —, Line —. Audited by —— ——.
(Return Audited.)
Name: The Aluminum Castings Company.
Business address: 6205 Carnegie Avenue, Cleveland, Ohio.
Kind of business: Manufacturers of Aluminum, Brass and Bronze Castings.
Date established: August 13, 1909.
(957.)

General Instructions

1. Complete Instructions.—For complete instructions concerning the filling of this form see Regulations No. 41 relative to the War Excess Profits Taxes imposed by the War Revenue Act approved October 3, 1917, referred to hereinafter as Excess Profits Tax Regulations. Copies can be obtained from any collector of internal revenue.

2. Who Must Make a Return on Form 1103.—Every corporation having for the taxable year a net income of $3,000 or more (see Form 1031) must make a return on this form of its average invested capital during the taxable year and compute the amount of its excess profits tax, if any, as directed herein.

This return should be made at the same time and in the same manner as the return of net income for the taxable year on Form 1031.

[fol. 100] A corporation which claims that it employs in its business only a nominal capital or that it cannot satisfactorily determine the amount of its invested capital must, nevertheless, fill this form as far as practicable in order to show the facts necessary for action on the claim.

3. Taxable Year.—The taxable year is the calendar year 1917 or (if the fiscal year of the corporation differs from the calendar year) the fiscal year ending in the calendar year 1917. A corporation whose fiscal year differs from the calendar year may also use this form for its return (without entries for prewar period) covering the fiscal year ending in 1918.

4. Taxable Income.—All the income of a corporation from whatever source derived is deemed to be derived from its business and all such income subject to the income tax is also subject to the excess profits tax except as provided for in Schedule I.

5. Deduction.—Each corporation whose income (derived from a business carried on with invested capital) is subject to excess profits tax may deduct from the amount of its taxable income (1) an amount equal to not less than 7 per cent and not more than 9 per cent of the amount of its invested capital, as explained below, and (2) $3,000.

If the corporation was not in existence during the whole of at least one of the calendar years 1911, 1912, and 1913, designated by the act of October 3, 1917, as the prewar period, and has not succeeded to the control of a business which was carried on during any one or more of those years, the first deduction is an amount equal to 8 per cent of the amount of invested capital. Otherwise the deduction is an amount equal to the same percentage of the invested capital for the taxable year as the average net income during the prewar period was of the average invested capital during that period, provided that if such percentage is less than 7 per cent, the deduction shall be computed at the rate of 7 per cent and if more than 9, at the rate of 9 per cent (see Excess Profits Tax Regulations, Article 21).

In order to take advantage of this provision, the corporation must make a return of invested capital during the

prewar period as well as during the taxable year. Space for such a return is provided on this form.

If the corporation prefers, it may compute the deduction at the rate of 7 per cent and avoid the necessity of render- [fols. 101 & 102] ing a return of invested capital for the prewar period. In any case the average amount of invested capital during the taxable year must be determined if possible.

6. Invested Capital.—For definition of "invested capital" and complete instructions for computing its amount see Excess Profits Tax Regulations, Articles 42 to 65.

7. Computation of Tax for Fiscal Year, Part of Which Falls in the Calendar Year 1917.—The tax of a corporation whose fiscal year differs from the calendar year shall be that proportion of the tax computed on the net income for the fiscal year which the number of months from January 1, 1917, to the end of the fiscal year bears to the entire number of months in the fiscal year.

8. Corporations making claim for assessment under Article 52 of the Regulations (section 210 of the act of October 3, 1917) should answer all questions and fill all schedules so far as possible and attach a statement explaining why it is impracticable or in the case of foreign corporations, unreasonably expensive to fill out the entire return.

[fols. 103 & 104] Schedule I.—Net Income for Taxable Year Subject to Excess Profits Tax

1.	Net income for taxable year shown in Item 8, Form 1031		$1,413,141.82
2.	Plus interest on obligations of the United States issued since September 24, 1917, held by corporation in excess of $5,000 par value		.....
3.	Total		1,413,141.82
4.	Less:		
	(a) Dividends received as shown in Item 3d, Form 1031	$.....	
5.	(b) Interest paid (not in excess of legal limit) on indebtedness incurred for purchase of obligations reported in item 2, above	.....	.....
6.	Net income subject to excess profits tax		$1,413,141.82

Schedule II.—Invested Capital

Item	1911	1912	1913	Taxable year
1. Capital, surplus, and undivided profits at the close of the preceding year as shown by corporation's books before making any adjustments therein (from Schedule A)	$1,118,307.15	$1,432,392.87	$1,478,725.39	$5,156,493.16
2. Adjustments by way of additions (from Schedule B)	.....	.....	.....	.....
3. Total	$1,118,307.15	$1,432,392.87	$1,478,725.39	$5,156,493.16
4. Adjustments by way of deductions (from Schedule C)	.....	.....	.....	.....
5. Invested capital at beginning of year (Item 3 less Item 4)	$1,118,307.15	$1,432,392.87	$1,478,725.39	$5,156,493.16
6. Changes in invested capital during year (from Schedules D and E)	.....	.....	.....	1,521,639.42
7. Invested capital for year	$1,118,307.15	$1,432,392.87	$1,478,725.39	$3,634,853.74
8. Total invested capital for prewar period				$4,029,425.41

Schedule III.—Deduction

1. Percentage—net income to invested capital for prewar period. (Item 6, Schedule 7, divided by Item 8, Schedule II.) Carry out result as far as desired, but drop the remainder, if any, without increasing the last figure of the percentage	17.5%
2. Percentage to be used in computing deduction (see Instruction 5)	9%
3. Amount of deduction computed at above rate on invested capital for taxable year	$327,136.83
4. Exemption (except for foreign corporations)	3,000.00
Total deduction	$330,136.83

Schedule IV.—Computation of Tax

Classes of income for computation of tax		Amount of income in each class	Deductions (if in excess of 15 per cent of invested capital, enter only 15 per cent on first line and balance on line or lines below)	Balance subject to tax	Rate	Amount of tax
Over—	But not over—					
1	2	3	4	5	6	7
$0.0	15 % of invested capital	$545,228.06	$330,136.83	$215,091.23	20%	$43,018.24
15 % of invested capital	20 % of invested capital	181,742.69	.....	181,742.69	25%	45,435.67
20 % of invested capital	25 % of invested capital	181,742.69	.....	181,742.69	35%	63,609.94
25 % of invested capital	33 % of invested capital	290,788.30	.....	290,788.30	45%	130,854.73
33 % of invested capital		213,640.08	.....	213,640.08	60%	128,184.05
Total		$1,413,141.82	$330,136.83	$1,083,004.99	....	$411,102.63

b3

Schedule A.—Capital, Surplus and Undivided Profits as Shown by Books Before Making Any Adjustments Therein

A4. Stock actually outstanding (not in the corporation treasury) at the end of the preceding taxable year may be counted as invested capital to the extent that it is paid up.

A6. Reserves consisting of amounts not deductible in the computation of net income under the income tax law, may, if properly explained, be included as part of the surplus for the purpose of computing the invested capital.

(957)

Item	1911	1912	1913	Taxable year
Capital stock paid up and actually outstanding at the close of the preceding year, not including treasury stock):				
1. First preferred	$400,000.00	$400,000.00	$400,000.00	.....
2. Second preferred	.....	.....	.....	.....
3. Common	400,000.00	400,000.00	400,000.00	400,000.00
4. Total	$800,000.00	$800,000.00	$800,000.00	$400,000.00
Surplus and undivided profits:				
5. Paid-in surplus	$.....	.....	.....	.....
6. Earned surplus	318,037.15	632,392.87	678,725.39	4,756,493.16
7. Undivided profits	.....	.....	.....	.....
8 Grand total of items 4, 5, 6, and 7	$1,118,307.15	$1,432,392.87	$1,478,725.39	$5,156,493.16

[fols. 107 & 108] Schedule B.—Adjustments by Way of Additions

B1. If any part of the interest on the corporation's permanent indebtedness was excluded as a deduction from the corporation's income for any year (see Form 1031), a proportionate part of such indebtedness may be added to invested capital for that year as Item 1, Schedule B.

B2. If any addition to invested capital is reported in Item 2, Schedule B, submit a full statement showing the kind of property, the date when paid in, its value on that date, and how the value was determined.

B3. If an addition to invested capital is reported in Item 3, Schedule B, submit a statement showing the kind of property, its cost, and the year in which it was acquired.

B4. If any addition to invested capital is reported in Item 4, Schedule B, state specifically the amount of depreciation or depletion written off each year in the books of the company and the amount allowed as a deduction in computing taxable income.

Item	1911	1912	1913	Taxable year
1. Proportion of permanent indebtedness, the interest on which is not deductible from income in computing income tax (Article 11)	$.....	$.....	$.....	$.....
2. Value of tangible property in excess of par value of stock issued therefor (Article 63)	.....	.....	.....	.....
3. Additions to capital account allowable under Article 64	.....	.....	.....	.....
4. Depreciation charged in accounts of corporation but disallowed by Treasury Department as expense on income tax returns	.....	.....	.....	.....
5.	.....	.....	.....	.....
6.	.....	.....	.....	.....
7 Total	$.....	$.....	$.....	$.....

[fol. 109] Schedule C.—Adjustments by Way of Deductions

C1. Is any good will, trade-mark, trade brand, franchise, or similar intangible property, paid in for stock entered on the books of the corporation at a value in excess of its actual cash value when paid in? No. In excess of the par value of the stock issued therefor? No. In excess (in the ag-

gregate) of 20 per cent of the par value of the stock outstanding on March 3, 1917? No.

If so, submit a statement showing (a) date of acquisition; (b) cash value at that date; (c) par value of stock issued therefor; (d) par value of total stock outstanding on March 3, 1917; and (e) value at which the assets are entered on the books of the corporation.

The amount by which "e" exceeds "b," "c," or 20 per cent of "d," whichever is lowest, must be entered as Item 1, Schedule C, for the taxable year and for each year of the prewar period that is affected.

C2. Is any patent or copyright, paid in for stock, entered on the books of the corporation at a value in excess of its actual cash value when paid in? No. In excess of the par value of the stock issued therefor? No.

If so, submit a statement showing (a) date of acquisition; (b) cash value of the patent or copyright at that date; (c) par value of the stock issued therefor; and (d) value at which the patent or copyright is entered on the books of the corporation.

The amount by which "d" exceeds "b" or "c," whichever is the lower, must be entered as Item 2, Schedule C, for the taxable year and for each year of the pre-war period that is affected.

C3. Is any tangible property, paid in for stock, entered on the books of the corporation at a value in excess of its actual cash value when received? No. In excess of the par value of the stock paid therefor? No.

Is any tangible property paid for specifically with stock before January 1, 1914, entered on the books of the corporation at a value in excess of its actual cash value on that date? No.

If the answer to any of the foregoing questions is "yes," submit a statement showing (a) kind of property; (b) when acquired; (c) par value of the stock paid therefor; (d) actual cash value of the property when paid in; (e) actual cash value of the property on January 1, 1914, if paid in [fol. 110] before that date; (f) basis of the valuation stated under "e"; (g) value at which the property is entered on the corporation's books; and (h) amount by which such value exceeds the allowable value under Article 55 of the Excess Profits Tax Regulations. Enter this amount as

Item 3, Schedule C, for the taxable year and for each year of the prewar period that is affected. (Note that the value January 1, 1914, does not affect the prewar period.)

C4. (a) Was any stock issued by the corporation ever returned as a gift or for a consideration substantially less than its par value. No. (b) If so, what was the par value of such stock? ——. (c) What amount of cash or its equivalent was derived from the resale of such stock? $——.

The excess of "b" over "c" must be entered as Item 4, Schedule C, for the taxable year and for each year of the prewar period that is affected.

C5. Was the business reorganized or consolidated, or was its ownership changed after March 3, 1917? No. If so, answer the following questions:

(a) Did an interest in the business of 50 per cent or more remain in the control of the same persons, corporations, associations, or partnerships, or of any of them? ——.

(b) Were any of the assets entered on the books of the corporation making this return at a higher value than on the books of its predecessor? ——.

(c) If so, were such assets paid for specifically as such in cash or tangible property? ——.

The increase in book value of any property not so paid for must be deducted from the invested capital for the taxable year as Item 5, Schedule C, unless it can be shown that under the excess profits law and regulations the property was undervalued on the books of the predecessor business.

C6. Is any propery paid for with cash or with other tangible property entered on the books of the corporation at a value in excess of the amount of cash paid therefor or the actual cash value of the tangible property paid therefor? No. If so, submit a statement showing (a) kind of property; (b) amount of cash paid therefor; (c) actual cash value of other tangible property paid therefor; (d) how that value was determined; (e) value at which the property is entered on the books of the corporation; and [fols. 111 & 112] (f) excess of "e" over "b" or "c." This excess must be entered as Item 6, Schedule C, for the taxable year and for each year of the prewar period that is affected.

C7. Has adequate provision been made in the expense accounts of the company for (a) losses of every kind?

Yes; (b) depreciaiton? Yes; (c) obsolescence? Yes; (d) depletion of mineral deposits, timber supplies and the like? ——.

If adequate charge has not been made for depreciation, depletion, obsolescence, and other losses, and the value of the property has not been maintained by replacements that have been charged to expense, proper additional charges for depreciation must be computed for all years in which they were not made on the books, and the total amount of such charges must be entered as Item 7, Schedule C, for the taxable year (and for each year of the prewar period that was affected) and deducted in arriving at its surplus and undivided profits.

C8. Has the corporation any stocks, bonds (other than obligations of the United States), or other assets, the income from which is not subject to excess profits tax? Yes. If so, at what value are they carried on the corporation's books? $140,795.83. Has any portion of such assets been included in invested capital in accordance with Articles 45 and 46 of the Excess Profits Tax Regulations? No. If so, how much? $——. Is the balance in excess of the corporation's indebtedness, excluding the amount thereof that has been included in invested capital as Item 1, Schedule B? No. If so, state the amount of such excess. $——.

Enter this amount as Item 8 in Schedule C, for the taxable year, and make a similar correction for each year of the prewar period.

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[fols. 113 & 114] Page 3

Schedule C.—Adjustments by Way of Deductions (Concluded)

Adjustment on account of (see corresponding instructions on page 2)—	1911	1912	1913	Taxable year
1. Valuation of good will, trade-marks, trade brands, franchises, or other intangible property purchased with stock (Articles 57 and 58).....	$.....	$.....	$.....	$.....
2. Valuation of patents and copyrights paid in for stock (Article 56).	.....	.....	.....	.....
3. Valuation of tangible property paid in for stock (Article 55).....	.....	.....	.....	.....
4. Stock returned to corporation as a gift, etc. (Article 54).....	.....	.....	.....	.....

Schedule C—Continued

Adjustment on account of (see corresponding instructions on page 2)—	1911	1912	1913	Taxable year
5. Valuation of assets acquired in reorganizations (Article 50)	.....	(957)	.....	.....
6. Appreciation (Article 42)	.....	.....	.....	.....
7. Depreciation and depletion (Article 42)	.....	.....	.....	.....
8. Excess of stocks and other inadmissible assets over indebtedness (Article 44)	.....	.....	.....	.....
9.	.....	.....	.....	.....
10.	.....	.....	.....	.....
11. Total deductions	$.....	$.....	$.....	$.....

Schedule D.—Changes in Invested Capital During Taxable Year

Specify (by using red ink for distributions, or otherwise) whether each item represents an addition or a distribution.

Report dividends paid out of profits of prior years but not dividends paid out of profits of the taxable year.

In column 4 enter the number of whole months remaining in the year, plus a fraction consisting of the number of days remaining in the month (including the date of change) divided by the total number of days in the month.

Assets (other than cash) paid in for stock, must be valued in accordance with Articles 55 to 60 of the Excess Profits Tax Regulations.

[fols. 115 & 116]

Nature of additions and distributions 1	Date 2	Amount 3	Number of months effective 4	Adjusted average. (Column 3 × column 4 / 12) 5
1. Dividends paid January less profits	January	$1,297,604.65	11	$1,189,470.93
2. Dividends paid February less profits	February	398,608.19	10	332,168.49
3.				
4.				
5.				
6.				
7.				
8.				
9. Net addition or reductions		$		$1,521,639.42

Schedule E.—Changes in Invested Capital During Prewar Period

See instructions under Schedule D. Compute net addition or reduction separately for each year

Nature of additions and distributions 1	Date 2	Amount 3	Number of months effective 4	Adjusted average. (Column 3 × column 4 / 12) 5
1.		$		$
3.				
2.				
4.				
5.				
6.				
7.				
8.				
9.				
10.				
11.				

Schedule E.—Continued

Nature of additions and distributions	Date	Amount	Number of months effective	Adjusted average. (Column 3 × column 4 / 12)
1	2	3	4	5
12.				
13.				
14.				
15.				
16.				
17.				
18.				

Schedule F.—Net Income During Prewar Period

Item	1911	1912	1913
1. Net income for year as reported on income tax return. (Dot not include figures for less than a whole year's income)	$388,606.73	$103,168.59	$208,441.98
2. Plus amount of Federal income tax paid during year	2,022.88	3,836.07	981.69
3. Total for each year	390,629.61	107,004.66	209,423.67
4. Less amount of dividends received in 1913			
5. Net total for year 1913			209,423.67
6. Grand total for prewar period			707,057.94

(Seal)
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[fol. 117] Page 4

Questions (957)

1. Explain the nature of the corporation's business if not adequately described on first page:

(a) Main business: Manufacturers of Aluminum, Brass and Bronze Castings.

(b) Collateral businesses, if any: None.

2. Date of incorporation: August 13, 1909.

3. Under the laws of what State or country? Ohio.

4. Enter on the following lines the names and addresses of three representative concerns in your locality engaged in the same kind of business: None.

5. What was the fair value of the total capital stock of the corporation as determined in the last assessment of the capital stock tax (if any)? Specify the year. Year ended June 30, 1917, $4,972,209.28.

6. If any patent is included among your assets, attach a schedule to this return showing for each patent its serial number, date of issue, name of patentee, amount of cash or stock paid therefor, and its present book value. ——.

7. If the corporation ever took over a going business or otherwise acquired a mixed aggregate of tangible property, patents, and copyrights, and good will and other similar intangible property, and paid for such property in whole or in part with stock or other securities, submit a statement showing—

(a) The name of the concern taken over (or from which the property was acquired).

(b) The nature of the assets and liabilities so acquired.

(c) The total par value of the stock issued therefor.

(d) The value at which each class of assets was carried on the books of the concern from which acquired. (If obtainable submit a balance sheet of the predecessor corporation as at the date of acquisition).

(c) The value at which each item was entered on the books of the corporation making this return. The different [fol. 118] classes of property must be valued as prescribed by Article 59 of the Excess Profits Tax Regulations and the values so obtained must be used in making adjustments 1, 2, and 3, Schedule C.

If patents or copyrights were acquired, state the basis on which their value was determined, and how they were paid for.

If good will or other intangible assets were acquired, state the basis on which their value was determined, and how they were paid for.

8. Is the corporation affiliated with one or more other corporations within the meaning of Article 77 of the Excess Profits Tax Regulations? No, except as below stated.

If so, submit a statement describing all its intercorporate relationships. The Aluminum Castings Company owns all of the stock of The Allyne Brass Foundry Company, a defunct corporation which ceased to do business October, 1916, and has consequently since said time had no income.

9. Is this return a consolidated return within the meaning of Article 78 of the Excess Profits Tax Regulation? No. If so, submit a schedule showing in detail the computation of the consolidated invested capital and income.

10. If the corporation was not in existence during the whole of any one of the calendar years 1911-1913, is its business substantially a continuation of a business carried on during any one or more of those years? ——. If so, give name under which, and address at which, its business was then carried on. ——.

11. Submit a copy, in detail, of—

(a) The balance sheet of the corporation at the beginning of the taxable year.

(b) The balance sheet of the corporation at the close of the taxable year.

We, the undersigned, president and treasurer of the above-named company, being severally duly sworn, each

for himself deposes and says that the foregoing return, [fol. 119] including the accompanying schedules and statements (if any), has been examined by him and is to the best of his knowledge and belief a true and complete return made in good faith pursuant to the Excess Profits Tax Regulations.

E. E. Allyne, President. J. F. McCashen, Treasurer.

Sworn to and subscribed before me this 28th day of Mch., 1918. W. E. Traster, Notary Public. (Seal.)

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The Aluminum Castings Company

Balance Sheet

December 31, 1917

Assets

Permanent Assets and Plant		$2,030,568 28	
Less Reserve for Depreciation		215,898 58	
			1,814,669 70
Patents, Processes, etc.			47,790 32
Investment Account:			
Liberty Bonds		377,100 00	
Miscellaneous		605 00	
			377,705 00
Prepaid Expenses			13,990 13
Accrued Interest			3,186 47
Current Assets:			
Inventories:			
Metal	1,171,267 13		
Finished Castings	264,842 04		
Work in Process	223,528 05		
Supplies	271,376 25		
Materials and Supplies for Special orders	20,000 00		
		1,951,013 47	

Accounts receivable Less Reserves		1,736,090 51	
Notes Receivable		21,916 74	
Cash on Hand and in Bank		675,105 12	
			4,384,125 84
Total			$6,641,467 46

Liabilities

Common Capital Stock			400,000 00
Current Liabilities:			
Accounts Payable		1,954,430 66	
Unpaid Labor		33,485 60	
			1,987,916 26
Accrued Taxes			
Reserves:			
For Liability Insurance		10,558 96	
For Fire Insurance		10,140 00	
For Federal Income Tax		471,234 99	
			491,933 95
Profit Twelve Months Ended Dec. 31, 1917			1,025,955 19
Surplus Jan. 1, 1917	4,756,493 16		
Less:			
Dividends	2,048,000 00		
		2,708,493 16	

Common Capital Stock 512%.

Balance Sheet—Continued

Profit & Loss Charges and Credits Applicable to Prior Years	27,168 90	
Surplus Dec. 31, 1917		2,735,662 06
Total		6,641,467 46

b-7.

[fol. 121]

(957)

The Aluminum Castings Company

Balance Sheet

December 31, 1916

Assets

Permanent Assets and Plant	$1,673,434 04	
Less Reserve for Deprec.	153,850 58	
		1,519,583 46
Patents, Processes, Etc.		47,790 32
Investment Account:		
The Allyne Brass Fdy. Co. Stock	140,190 83	
Miscellaneous	5,605 00	
		145,795 83
Prepaid Expenses		20,455 94

Current Assets:			
Inventories:			
Metals	1,112,229.87		
Finished Castings	343,792.12		
Supplies	119,441.97		
Work in Process	77,742.10		
Materials and Supplies for Special Orders	31,958.16		
		1,685,164.22	
Accounts Rec. Less Reserves		2,226,149.24	
Notes Receivable		25,000.00	
Cash on Hand and in Bank		1,493,539.76	
			5,429,853.22
Total			$7,163,478.77

Liabilities

Common Capital Stock			400,000.00
Current Liabilities:			
Accounts Payable		1,668,409.20	
Unpaid Labor		19,619.90	
			1,688,029.10
Accrued Taxes			5,481.13
Reserves:			
For Commissions		88,913.87	
For Liability Insurance		12,724.34	

Balance Sheet—Continued

For Fire Insurance		5,070.00	
For Legal Expense		4,075.05	
For High Priced Metal		67,407.24	
For Federal Income Tax		108,006.55	
For Open Receiving Slips		12,278.33	
For Unadjusted Claims		15,000.00	
			313,475.38
Profit Twelve Months Ended Dec. 31, 1916			5,292,320.97
Surplus Jan. 1, 1916			1,577,373.49
[fol. 122] Less			
Dividends:			
Common Capital Stock 518%	2,072,000.00		
Preferred Capital Stock 3%	10,983.00		
Premium on 3661 shares preferred Stock retired at 105	18.305.00		
Profit and Loss Charges and Credits Applicable to Prior Years (Net)	11,913.30		
		2,113,201.30	
Surplus Dec. 31, 1916			535,827.81
Total			$7,163,478.77

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[fol. 123] (957)

The Aluminum Castings Company

Trial Balance

August 13, 1909

	Debit	Credit
Allyne Brass Foundry Co. Ohio.	$18,484 00	
Eclipse Foundry Company	6,602.00	
Allyne Brass Foundry Co., Mich.	36,113.00	
Syracuse Alum. & Bronze Co		$16,815 00
Allyne Brass Foundry Co., New York	5,121 00	
U. S. Aluminum Company	156,497.00	
Sub. to Common Capital Stock		400,000.00
Capital Stock Preferred		400,000 00
Real Estate	125,467.00	
Building Structures	118,688 77	
Core Ovens & Equipment	6,822.23	
Furnaces	17,747 71	
Molding Machines	24,422 65	
Machinery & Tools	33,137.00	
Pipes & Fittings	6,446 91	
Fire Equipment	1,393.82	
Electric Light Wiring	3,236 49	
Benches, Racks, etc.	3,091.77	
Belting & Lacing	1,929.23	
Office Furniture & Fixtures	4,106 17	
Trucking & Stables	2,456.87	
Power Equipment	11,218.77	
Portable Tools	12,039.39	
Wood Flasks	8,159 24	
Metal Flasks	5,137 22	
Core Plates	5,533.81	
Miscellaneous Equipment	4,103.99	
Patterns	5,644.43	
Patents	300 00	
Plumbers Supplies	19,166 53	
Supplies	16,869.00	
Finished Product Alum	18,048.00	
Metals	138,487 00	
Prepaid Expenses	344.00	
	$816,815.00	$816,815.00

(Q. 7)

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[fol. 124] (a) The Aluminum Castings Company has taken over the assets, except cash on hand and bills and accounts receivable, of the following concerns, namely, The Allyne Brass Foundry Company, The Allyne Brass Foundry Company of Michigan, The Allyne Brass Foundry Company of New York, The United States Aluminum Company, The Syracuse Aluminum & Bronze Company, and The Eclipse Foundry Company, paying therefor in whole or in part with stock.

(b) The assets so acquired were all of the assets of the above mentioned companies except cash on hand and bills and accounts receivable, including real estate, buildings, machinery, merchandise, finished and unfinished, supplies, etc. No liabilities were acquired except material contracts for future deliveries and certain taxes.

(c) The total par value of the stock issued therefor was $573,748.00.

(d) We have no data from which to answer this question.

(e) The value at which each item was entered on the books of The Aluminum Castings Company is shown by the trial balance hereto annexed. The only item of patents or copyrights is $300.00. We cannot tell the basis on which this value was determined. It was paid for either in cash or stock at par. No good will or other intangible assets were acquired.

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(Here follow Plaintiff's Exhibits Nos. 5 and 6, side folios 125-126 and 127-128)

[fols. 125 & 126]

PLAINTIFF'S EXHIBIT NO. 5

(Filed Nov. 11, 1927)

Aluminum Castings Company

Analysis of Accrued Tax Account and Reserve for Federal Income

Date, 1916	J. E. No.		Cleveland	Detroit	Elmwood
Jan. 1st.	....	Balance	1,446 00 Cr.	24 21 Dr.	770 94 Dr.
31st.	5955	Jan. Proration of Taxes	235 44	538 53	150 48
Feb. 28th.	6042	Feb. Proration of Taxes	235 45	538 53	150 52
Mar. 31st.	6104	March Proration of Taxes	235 45	538 55	169 04
Apr. 29th.	6168	April Proration of Taxes	235 46	538 55	163 47
May 31st.	6243	May Proration of Taxes	235 45	538 55	163 45
June 30th.	6279	June Proration of Taxes	235 46	538 55	163 46
30th.	6362	To cover estimated increase of 20% on first Half 1916 taxes.	282 54	646 25	192 08
July 31st.	6429	July Proration of Taxes	235 45	503 29	181 88
Aug. 31st.	6513	August Proration of Taxes	235 46	503 30	181 89
Sept. 30th.	6635	Sept. Proration of Taxes	235 45	503 30	181 88
Oct. 31st.	6759	Oct. Proration of Taxes	507 64	1,171 62	181 90
31st.	6769	Accrued to cover estimated taxes on Bank Balances for entire year 1916 and prorated over Oct., Nov. and Dec.	1,500 00	.....	.....
Nov. 30th.	6848	Nov. Proration of Taxes	507 64	1,171 63	181 88
30th.	6850	Nov. Portion of accrual to cover estimated taxes on Bank Balances for 1916	1,500 00	.....	.....
Dec. 31st.	6962	Dec. Proration of Taxes	406 40 Dr.	1,171 63	181 88
31st.	6970	Dec. Portion of accrual to cover estimated taxes on Bank Balances for 1916	1,665 00	.....	.....
Jan. 31st.	5954	Accrual	100 00	.....	.....
Feb. 28th.	6038	Accrual	100 00	.....	.....
Mar. 31st.	6101	Accrual	100 00	.....	.....
Apr. 29th.	6166	Accrual	100 00	.....	.....
May 31st.	6238	Accrual	100 00	.....	.....
June 30th.	6286	Accrual	100 00	.....	.....
Dec. 31st.	....	Federal Income Tax Reserve	108,006 55	.....	.....
		Total Accrued for 1916	116,282 04	8,902 28	2,243 81
		Bal. Jan. 1st. 1916			
		Paid 1916			
		Bal. Dec. 31st. 1916			

PLAINTIFF'S EXHIBIT No. 5

(Filed Nov. 11, 1927)

Aluminum Castings Company

Accrued Tax Account and Reserve for Federal Income Tax, Year 1916

	Cleveland	Detroit	Elmwood	Fairfield	Manitowac	Niagara	Detroit machine shop	Total
	1,446 00 Cr.	24 21 Dr.	770 94 Dr.	126 10 Cr.		518 21 Dr.		158 74 Cr.
	235 44	538 53	150 48	11 31	41 23	102 14	33 33	1,112 46
	235 45	538 53	150 52	11 32	41 23	106 21	33 34	1,116 60
	235 45	538 55	169 04	11 32	41 24	124 78	33 33	1,153 71
	235 46	538 55	163 47	11 32	41 24	112 39	33 34	1,135 77
	235 45	538 55	163 45	10 51	41 24	112 40	33 33	1,134 93
	235 46	538 55	163 46	10 51	41 24	112 39	33 33	1,134 94
es.	282 54	646 25	192 08	13 26	49 48	134 06	40 00	1,357 67
	235 45	503 29	181 88	50 90	41 24	124 79	41 67	1,179 22
	235 46	503 30	181 89	50 90	41 24	124 78	41 67	1,179 24
	235 45	503 30	181 88	50 90	41 24	124 78	41 66	1,179 21
	507 64	1,171 62	181 90	50 90	41 24	159 27	41 67	2,154 24
for								
	1,500 00							1,500 00
	507 64	1,171 63	181 88	50 89	41 24	159 29	41 67	2,154 24
nk								
	1,500 00							1,500 00
	406 40 Dr.	1,171 63	181 88	50 89	461 47	159 28	41 66	1,660 41
nk								
	1,665 00							1,665 00
	100 00							100 00
	100 00							100 00
	100 00							100 00
	100 00							100 00
	100 00							100 00
	100 00							100 00
	108,006 55							108,006 55
	116,282 04	8,902 28	2,243 81	384 93	964 57	1,656 56	490 00	130,924 19
								258 74
								131,182 93
								17,695 25
								113,487 68

[fols. 127 & 128]

PLAINTIFF'S EXHIBIT No. 6

(Filed Nov. 11, 1927)

The Aluminum Castings Comp

Analysis of Accrued Tax Account and Reserve for Fed

Date	J. E. No.		Cleveland	Cleveland "N" plant	Detroit	Detroit A plan
Jan. 1.		Balance	109,260 59 Cr.		4,628 81 Cr.	
Jan. 31.	7132	Accrual to cover ext. taxes on Bank Balances January.	1,000 00			
31.	7144	Jan. Proration of taxes	227 32		1,171 63	50 00
Feb. 28.	7202	Feb. Proration of taxes	227 33		1,171 63	50 00
28.	7211	Accrual to cover est. taxes on B. B. Feb.	1,000 00			
Mar. 31.	7304	Mar. Proration of taxes	227 33		1,188 46	15 97
31.	7313	Accrual to cover est. taxes on B. B. March	1,000 00			
Apr. 30.	7404	April Proration of taxes	227 33		1,140 72	15 97
May 31.	7481	May Proration of Taxes	227 33		1,044 19	15 97
June 30.	7604	June Proration of Taxes	227 32		1,044 21	15 97
30.	7634	June Proration Addtl.				
July 31.	7705	July Proration of Taxes	227 32	12 42	954 45	93 56
Aug. 30.	7807	Aug. Proration of Taxes	227 34	12 37	954 31	93 46
Sept. 30.	7888	Sept. Proration of Taxes	227 33	12 37	954 91	93 46
Oct. 31.	8083	Oct. Proration of Taxes	227 32	12 37	942 83	93 46
Nov. 30.	8129	Nov. Proration of Taxes			77 46	
30.	8179	Nov. Proration of Taxes			3 71	
30.	8186	Nov. Proration of Taxes	227 33	12 37	946 57	93 46
Dec. 31.	8286	Dec. Proration of Taxes	227 34	12 37	946 57	93 46
31.	8367	Dec. Proration of Taxes				
Mar. 31.	7314	Accrual Cap. Stock Taxes (Ohio)	150 00			
Apr. 30.	7402	Accrual Cap. Stock	50 00			
May 31.	7479	Accrual Cap. Stock	50 00			
June 30.	7602	Accrual Cap. Stock	50 00			
July 31.	7701	Accrual Cap. Stock	50 00			
Aug. 31.	7814	Accrual Cap. Stock	50 00			
Sept. 30.	7880	Accrual Cap. Stock	50 00			
Oct. 31.	8074	Accrual Cap. Stock	50 00			
Nov. 30.	8188	Accrual Cap. Stock	50 00			
Dec. 31.	8263	Accrual Cap. Stock	50 00			
Dec. 31.	J 290	Federal Income Tax				
		Reserve 1917	527,396 17			
		Total Taxes Accrued for 1917	533,724 11	74 27	12,541 65	724 74

Balance Jan. 1st, 1917

Paid 1917

Diff. between accrual and payment of 1916 Fed. Income Tax

Balance December 31st, 1927

PLAINTIFF'S EXHIBIT No. 6

(Filed Nov. 11, 1927)

The Aluminum Castings Company

Account and Reserve for Federal Income Tax Year 1917

Detroit	Detroit A plant	Elmwood	Fairfield	Manitowoc	Niagara	Detroit machine shop	Total
4,628 81 Cr.	.....	719 31 Dr.	142 59 Cr.	49 48 Cr.	364 48 Dr.	490 00 Cr.	113,487 68 Cr.
.....	.....	.....	.....	.....	.....	.....	1,000 00
1,171 63	50 00	180 48	10 50	82 71	138 46	41 66	1,902 76
1,171 63	50 00	172 40	10 51	82 71	138 46	41 66	1,894 70
.....	.....	.....	.....	.....	.....	.....	1,000 00
1,188 46	15 97	172 39	10 50	82 71	138 47	41 66	1,877 49
.....	.....	.....	.....	.....	.....	.....	1,000 00
1,140 72	15 97	172 37	41 23	82 71	138 46	41 66	1,860 45
1,044 19	15 97	172 40	13 11	82 71	138 47	41 66	1,735 84
1,044 21	15 97	172 39	13 11	82 71	138 48	41 66	1,735 85
.....	.....	.....	632 04	.....	.....	.....	632 04
954 45	93 56	254 97	118 42	82 71	165 48	41 66	1,950 99
954 31	93 46	254 78	118 40	82 71	165 35	41 66	1,950 38
954 91	93 46	254 79	118 40	82 71	165 36	41 66	1,950 99
942 83	93 46	254 78	118 40	82 71	165 35	41 66	1,938 88
77 46	.....	.....	.....	.....	.....	.....	77 46
3 71	.....	.....	.....	.....	.....	.....	3 71
946 57	93 46	254 79	118 40	82 71	165 36	41 66	1,942 65
946 57	93 46	4,899 35	118 40	82 71	5,175 37	41 66	11,597 23
.....	.....	1,071 48	.....	.....	.....	.....	1,071 48
.....	.....	.....	.....	.....	.....	.....	150 00
.....	.....	.....	.....	.....	.....	.....	50 00
.....	.....	.....	.....	.....	.....	.....	50 00
.....	.....	.....	.....	.....	.....	.....	50 00
.....	.....	.....	.....	.....	.....	.....	50 00
.....	.....	.....	.....	.....	.....	.....	50 00
.....	.....	.....	.....	.....	.....	.....	50 00
.....	.....	.....	.....	.....	.....	.....	50 00
.....	.....	.....	.....	.....	.....	.....	50 00
.....	.....	.....	.....	.....	.....	.....	50 00
.....	.....	.....	.....	.....	.....	.....	.....
12,541 65	724 74	8,287 37	1,441 42	992 52	6,833 07	499 92	527,396 17
							565,119 07
							113,487 68
							678,606 75
						157,604 49	.....
						2,066 06	159,670 55
							518,936 20

[fol. 129] PLAINTIFF'S EXHIBIT No. 7

Treasury Department Opinions, Regulations and Decisions

(Filed Nov. 28, 1927)

10-21-1503. L. O. 1059

"Section 214 (a) 3, Article 131: Taxes

(Also Section 212, Article 23)

Corporation Income Tax—Revenue Act of 1916, Section 12(a); Section 13(d)

Method of Computing and Accounting for Munition Manufacturer's Tax When Taxpayer's Accounts are Kept on the Accrual Basis

Where a corporation in 1916 kept its accounts on the accrual basis, and either accrued munitions taxes or credited amounts to a reserve set up to meet such taxes, thus taking advantage of section 13(d) of the Revenue Act of 1916, it became bound by the provisions of that section and Treasury Decision 2433, and the amounts so accrued or credited must, in computing income subject to tax for 1916, be deducted from gross income for that year, and not for 1917, during which year such munitions taxes were paid.

Section 13(d) of the Revenue Act of 1916 is a qualifying section, and when accounts of a corporation are kept on a basis other than that of receipts and disbursements it qualifies the manner of making deductions authorized in section 12(a) of the Act, and the word 'paid' in the latter section is to be read 'paid or accrued,' depending on how the accounts of the corporation are kept.

The question is presented whether the M Company, a corporation, considering the basis upon which its accounts are kept, is required, in computing its income tax for the calendar year 1916, to accrue munitions taxes assessed

against the company under Title III of the Revenue Act of 1916, and deduct the amount thereof from gross income in its tax return for that year.

The company, in its tax return for 1916, made no deduction from gross income on account of munitions taxes assessed for that year, but claims the right to and did deduct the amount of such taxes in its tax return for 1917. [fol. 130] This was in accordance with the consistent policy of the company, which has made it a practice since 1912 to deduct in its tax returns only the amount of taxes actually paid during the year for which the returns were rendered.

The munition manufacturer's tax is an excise tax of twelve and one-half per centum upon the entire net profits actually received or accrued for the year 1916 from the sale or disposition of certain articles therein specified, manufactured in the United States.

In computing net income subject to tax under Part II of Title I of the Revenue Act of 1916, domestic corporations were allowed certain deductions from their gross income. Those deductions are enumerated in section 12(a) of the Act. The provisions relating to general items of expense and taxes read as follows:

Sec. 12(a). In the case of a corporation, joint-stock company or association, or insurance company, organized in the United States, such net income shall be ascertained by deducting from the gross amount of its income received within the year from all sources—

First. All the ordinary and necessary expenses paid within the year in the maintenance and operation of its business and properties, including rentals or other payments required to be made as a condition to the continued use or possession of property to which the corporation has not taken or is not taking title, or in which it has no equity.

* * * * * * *

Fourth. Taxes paid within the year imposed by the authority of the United States. * * * or of its Territories, or possessions, or any foreign country, or by the authority of any State, county, school district, or munici-

pality, or other taxing subdivision of any State, not including those assessed against local benefits.

The proper treatment of the item munitions taxes for income tax purposes depends not only upon the construction to be placed on the word 'paid' as used in this section, but also upon the effect of section 13(d) of the Act concerning the methods of keeping accounts, and Treasury Decision 2433.

Under revenue acts prior to the Revenue Act of 1916, the only recognized basis for keeping accounts was that of actual receipts and disbursements. Giving official recog- [fol. 131] nition to the fact that it is the common practice for all large business enterprises to keep their accounts on the accrual basis, this Department permitted the accrual of certain items of expense and the use of inventories. This practice was adopted to effectuate as nearly as possible, without doing violence to the language employed, the real purpose of those Acts, namely, to reflect the true income of the taxpayer upon which the tax was levied. However, taxes were not permitted to be accrued. They were deductible only in the year in which actually paid, and this remained the practice at least until the Revenue Act of 1916 became effective.

Section 13(d) of the Revenue Act of 1916 is as follows:

A corporation, joint-stock company or association, or insurance company, keeping accounts upon any basis other than that of actual receipts and disbursements, unless such other basis does not clearly reflect its income, may, subject to regulations made by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, make its return upon the basis upon which its accounts are kept, in which case the tax shall be computed upon its income as so returned.

This is the first time the law specifically recognized keeping accounts, for income tax purposes, on any basis other than that of receipts and disbursements, and even then no other basis was to be used if the taxpayer's income thereunder was not clearly reflected, and in no event was another basis to be used unless it was in conformity with regulations made by the Commissioner with the approval

of the Secretary. Formal consent in each individual case upon application made to making returns of income on the basis upon which accounts were kept was not necessary. But there were two necessary requisites: First, the accounts must have clearly reflected true income; second, if a system other than receipts and disbursements were used, it must have been subject to regulations made by the Commissioner.

This Act was approved September 8, 1916, and shortly thereafter on January 8, 1917, Treasury Decision 2433 was approved by the Secretary. This Treasury decision, after quoting section 13(d) as above, reads as follows:

[fol. 132] Under this provision it will be permissible for corporations which accrue on their books monthly or at other stated periods amounts sufficient to meet fixed annual or other charges to deduct from their gross income the amounts so accrued, provided such accruals approximate as nearly as possible the actual liabilities for which the accruals are made, and provided that in cases wherein deductions are made on the accrual basis as hereinbefore indicated income from fixed and determinable sources accruing to the corporations must be returned, for the purpose of the tax, on the same basis.

In cases wherein, pursuant to the consistent practice of accounting of the corporation, or pursuant to the requirements of some Federal, State, or municipal supervising authority, corporations set up and maintain reserves to meet liabilities, the amount of which and the date of payment or maturity of which is not definitely determined or determinable at the time the liability is incurred, it will be permissible for the corporations to deduct from their gross income the amounts credited to such reserves each year, provided that the amounts deductible on account of the reserves shall approximate as nearly as can be determined the actual amounts which experience has demonstrated would be necessary to discharge the liabilities incurred during the year and for the payment of which additions to the reserves were made; and provided if it shall be found that the amount credited to any such reserve is in excess of the reasonable or probable needs of the corporation to meet and discharge the liabilities for which the reserve is credited, the excess of such reserve over and

above the reasonable or probable needs for the purpose indicated shall be at once disallowed as a deduction and restored to income for the purpose of the tax; and provided further that in no event will sinking funds or other reserves set up to meet additions, betterments, or other capital obligations constitute allowable deductions from gross income.

This ruling contemplates that the income and authorized deductions shall be computed and accounted for on the same basis and that the same practice shall be consistently fol- [fol. 133] lowed year after year. Amounts paid in discharge of any liability or obligation for which a reserve has been set up, as hereinbefore outlined, will, when paid, be charged to the reserve created to meet it in so far as such reserve is sufficient to meet the liability, provided always that the liability is of a character which constitutes an allowable deduction within the meaning of the law.

If upon investigation it shall be found that returns made upon the basis of accruals and reserves do not reflect the true net income, the corporation so failing in this way to return the true net income will not thereafter be permitted to make its returns upon any basis other than that of actual receipts and disbursements.

The reserves contemplated by the foregoing ruling are those reserves only which are set up to meet some actual liability incurred, the amount necessary to discharge which can not at the time be definitely determined, and do not contemplate reserves to meet losses contingent upon shrinkage in values, losses from bad debts, capital investments, etc., which losses are deductible only when definitely determined as the result of a closed or completed transaction and are charged off.

The company contends, notwithstanding section 13(d) and Treasury Decision 2433, that the wording of the statute, 'Taxes paid within the year' precludes their deduction in any year except that in which they were actually paid. If this be true, we have a peculiar and anomalous situation in connection with the company's returns. It admits, and its returns so show, that the ordinary and necessary expenses incurred within the year 1916 in the maintenance and operation of its business and property, provided for

in the first subdivision of section 12(a), were accrued on its books and deducted in its tax return for 1916, whether or not such expenses were actually paid within that year. Likewise, all items of income, whether or not actually received, were accrued and included in gross income. So far as the statute is concerned, there is nothing to indicate that the expenses referred to in the first subdivision of section 12(a) should be accrued and deducted as accrued, and that taxes referred to in subdivision 4 thereof should be deducted only in the year in which paid. The word [fol. 134] 'paid' is used in identically the same manner in both subdivisions without qualifying words, and according to rules of statutory construction the deductions classified thereunder must receive like treatment.

There would be great force to the argument that the wording of the statute 'Taxes paid within the year' precludes their deduction in any year except that within which they are actually paid were it not for section 13(d). In construing a statute, full consideration must be given to all its provisions, and a construction adopted that will permit all sections to harmonize if possible. In framing the Revenue Act of 1916 it was contemplated, as theretofore, that accounts ordinarily were kept on the receipts and disbursements basis; hence the use of the word 'paid' in connection with all items of deductions enumerated in section 12(a). But desiring to recognize other systems of keeping accounts, section 13(d) was inserted, which was designed especially to recognize the system of accrued accounting; that is, that all items of income and outgo be either actually determined or estimated as they accrue and that the proper entries be made upon the books at that time, returns of income be made on that basis, and the tax paid accordingly. To this extent, then, section 13(d) is a qualifying section, and when accounts are kept on the accrual basis, so as to bring the taxpayer within this section, it qualifies the word 'paid' and the manner of making deductions allowed in section 12(a). The word 'paid' therefore, is to be read 'paid or accrued,' depending on how the accounts of the taxpayer are kept.

It is further contended by the company that it did not accrue munitions taxes but only set up a reserve to meet this liability, the amount of which was not definitely de-

termined until some time in 1917, and even if these taxes were accrued on its books it is still proper, in view of the wording of the statute, and the fact that Treasury Decision 2433 merely gives corporations permission to use the accrual basis and does not require it, to deduct taxes only in the year in which paid. The company attempts to draw a fine distinction between accruals and reserves, the only difference being, so far as its brief shows, that a liability is accrued when the amount thereof is definitely ascertainable and a reserve is set up to meet a liability when the amount thereof can not be accurately determined. It also [fol. 135] relies on articles 152, 156, and 158 of Regulations 33, promulgated January 5, 1914, as governing the method of computing and accounting for deductions of taxes for 1916.

From reports of the revenue agent, copies of actual books entries taken from the books of the company, and statements submitted by officers of the company, I am convinced the taxes in question were accrued on the books of the company. The statement furnished by the revenue agent starts with the year 1915, and sets up the distribution made by the N Company and followed for the remainder of the year by its successor, the M Company. In that year the company accrued income taxes. In July, 1916, the successor company began to set aside monthly amounts chargeable against the earnings of that year through 'Undistributed Expense,' these amounts being credited to the account 'Federal Munitions Tax, 1916.' That the intention of the company was to accrue munitions taxes is shown by the explanations appearing on its books with reference to entries made in this account. The word 'accrued' is used several times in specifying amounts accrued to certain dates. The balance sheets of the company reflect the liability for that year in item 'Deferred Credits.' The schedule of this account sets up the compilation, which includes income taxes for 1916, x dollars; munitions tax for 1916, 5x dollars; accrued expenses, 4x dollars; total, 10x dollars.

The method of keeping this account discloses that instead of a general reserve being set up as an extra safeguard to take care of a possible but unknown liability, the company accrued from month to month the estimated

amount of munitions taxes it was required to pay and so constituted it a liability against the company's assets. This amount should not have been difficult to estimate, it being, as has been stated, twelve and one-half per centum of the net profits received during the year on the manufacture of certain products. Under the accounting method employed by the company it undoubtedly could estimate with great accuracy its probable profits from munitions operations, even though they could not be absolutely determined. While there may be a technical distinction in accounting between an accrual and a reserve, the setting up of a reserve is not inconsistent with the system of accrued accounting. Neither do I find anything in the law that distinguishes be- [fol. 136] tween them. The law looks only to whether the liability was actually incurred and does not prohibit the deduction of a proper reserve set up to meet a known liability that is a proper deduction. Law Opinion 360. Therefore, the fact that the company failed to make an accurate estimate of its munitions taxes for 1916 is not sufficient reason for deducting the amount of such taxes in 1917. Few accrued liabilities are estimated with absolute accuracy, and it is generally necessary to make adjustments from time to time in these accounts as the situation requires. This fact is recognized in Treasury Decision 2433.

We come now to the question of the effect of this Treasury decision. It is unnecessary to enter into a discussion of whether under the language used therein corporations were merely given permission or were required to use the accrual system of keeping accounts. It is sufficient to note that this company not only kept its accounts on the accrual basis, accruing munitions and other taxes, but rendered its tax returns on that basis, with the one exception that taxes were deducted in the year in which paid. In this respect there was a departure from the established method of accounting not warranted by the law or regulations. Having elected to report its income subject to tax on the basis on which its accounts were kept, thus taking advantage of section 13(d), which brought it within the provisions of this section and Treasury Decision 2433, the company became bound by its election and, having decided to accrue income, it must go the whole way and accrue liabilities instead of accounting for them on a different basis, except where the

Act specifically provides otherwise. Neither can it use one method in making one deduction, and a totally different method in making another deduction. The reason for this is obvious. Take, for instance, the item under discussion. Munitions taxes are an element of cost entering into every unit of production and which must be taken into consideration each year in computing net income subject to tax. It is an expense necessary to produce income, and income is improperly reflected if the deduction on this account is made the following year, as it is in no way related to the income of the latter year, and has the further effect of greatly inflating the income of the year to which it does relate. Such practice would be contrary to the provision contained [fol. 137] in the first sentence of paragraph four of Treasury Decision 2433 which contemplates 'that the income and authorized deductions shall be computed and accounted for on the same basis and that the same practice shall be consistently followed year after year,' and to the provisions of section 13(d) which permit returns to be made on a basis other than that of receipts and disbursements only when income is properly reflected.

But whether the amounts set aside to cover munitions taxes were accrued or set up as a reserve should not, in my opinion, make any difference so far as this case is concerned. The Treasury decision referred to provides for deducting from gross income amounts credited to reserves each year to meet liabilities, the amount and date of payment of which are not definitely determined or determinable at the time the liability is incurred. As stated in Law Opinion 360:

* * * With respect to a corporation making its return on an accrual basis, the crediting of an amount to a reserve to meet a given liability is equivalent to the payment of such liability by a corporation making its return on the basis of actual receipts and expenditures, subject only to the requirement that, if such reserve is 'in excess of the reasonable or probable needs of the corporation,' amounts so credited shall be restored to income. An amount credited to a reserve in 1916 is deducted, if at all, from income for the year 1916. Whether or not it shall be deducted depends therefore upon the law in force in 1916. * * * The sole question is as to the character of the re-

serve and that is to be determined by the law at the time when amounts are credited to it, rather than by the law at the time when payments are made from it.

It would, therefore, appear that even though this is a reserve for munitions taxes it must be deducted from gross income in 1916 or not at all. See A. R. M. 26, page 115, and A. R. M. 29, page 119, Cumulative Bulletin No. 2, 1920.

Articles 152, 156, and 158 of Regulations 33 promulgated January 5, 1914, are not applicable. Those regulations were adopted in pursuance of the Act of October 3, 1913, which did not recognize the accrual method of accounting, and the articles in question could have no application in this case where advantage was taken of a new provision in [fol. 138] a different Act, and in connection with which Treasury Decision 2433, which is inconsistent with those articles, was issued. For the same reason, the practice of the company established prior to 1916 of deducting taxes only in the year in which paid is not to be considered. What the company did in this respect prior to 1916, its 1916 return having been made under a new Act, has no bearing on the question here at issue, as the question arose under the new and not the old Act, the Acts being dissimilar.

It is held that where a corporation in 1916 kept its accounts on the accrual basis, and either accrued munitions taxes or credited amounts to a reserve set up to meet such taxes, thus taking advantage of section 13(d) of the Revenue Act of 1916, it became bound by the provisions of that section and Treasury Decision 2433, and the amounts so accrued or credited must, in computing income subject to tax for 1916, be deducted from gross income for that year, and not for 1917, during which year such munitions taxes were paid.

Section 13(d) of the Revenue Act of 1916 is a qualifying section, and when accounts of a corporation are kept on a basis other than that of receipts and disbursements, it qualifies the manner of making deductions authorized in section 12 (a) of the Act, and the word 'paid' in the latter section is to be read 'paid or accrued,' depending on how the accounts of the corporation are kept.

Carl A. Mapes, Solicitor of Internal Revenue."

"Regulations 33, Art. 156:

'Reserves for taxes cannot be allowed, as the law specifically provides that only such sums as are paid within the year for taxes shall be deducted.'

Regulations 33, Art. 158:

'Deductions for taxes, however, should be the aggregate of the amounts actually paid, as shown on the cash book of the corporation.'

A similar ruling was made as to interest.

Regulations 33, Art. 148:

'The interest to be deductible must have been computed on the proper principal at the contract rate and must have been actually paid within the year.' "

[fol. 139] "Letter addressed to Carey, Piper and Hall, Baltimore, Maryland, signed by Acting Commissioner David A. Gates and dated March 2, 1915, wherein the Acting Commissioner says:

'Accounts payable, representing ordinary and necessary expenses of maintaining and operating the business and property of a corporation, if actually charged into the Expense Account and so entered on the books as to constitute a liability against the assets of the company, and so treated in the preparation of the return of annual net income that they will not be included in the deductions in the year in which they are actually paid in cash, or its equivalent, such accounts payable may be deducted from the gross income of the year in which the expenses were incurred.

'This ruling applies only to accounts payable representing ordinary and necessary expenses of maintaining and operating the business, that is, to such expenses as are incurred by the corporation in producing the gross income which it is required to return.

'Accounts and bills receivable of a corporation are to be treated as income for the year in which they are created, that is to say, in the year in which the accounts are set up on the books or the bills receivable are accepted.' "

"Regulations 33, Art. 104:

'Gross income of manufacturing companies shall consist of the total sales of manufactured goods during the year covered by the return, increased or decreased by the gain or loss as shown by the inventories of finished and unfinished products, raw material, etc., at the beginning and end of the year.'"

Ruling of W. H. Osborn, Commissioner of Internal Revenue, to Collectors of Internal Revenue, dated September 14, 1916:

"Pending the adoption and promulgation of special regulations under the Act of September 8, 1916, Income Tax Regulations in Force September 8, 1916, are hereby extended and made applicable to the Act of September 8, 1916, so far as not inconsistent with the provisions of that statute."

[fol. 140] T. D. 2433:

January 8, 1917.

"Sub-paragraph (d) of Sec. 13, of Title I, of the Act of September 8, 1916, provides that

'A corporation, joint stock company or association, or insurance company, keeping accounts upon any basis other than that of actual receipts and disbursements, unless such other basis does not clearly reflect its income, may, subject to regulations made by the Commissioner of Internal Revenue with the approval of the Secretary of the Treasury, make its returns upon the basis upon which its accounts are kept, in which case the tax shall be computed upon its income as so returned.'

"Under this provision it will be permissible for corporations which accrue on their books monthly or at other stated periods, amounts sufficient to meet fixed annual or other charges, to deduct from their gross income the amounts so accrued, provided such accruals approximate as nearly as possible the actual liabilities for which the accruals are made, and provided that in cases wherein deductions are made on the accrual basis as hereinbefore indicated, income

from fixed and determinable sources accruing to the corporations must be returned, for the purpose of the tax, on the same basis.

"In cases wherein, pursuant to the consistent practice of accounting of the corporation, or pursuant to the requirements of some Federal, state, or municipal supervising authority, corporations set up and maintain reserves to meet liabilities, the amount of which and the date of payment or maturity of which, is not definitely determined or determinable at the time the liability is incurred, it will be permissible for the corporations to deduct from their gross income the amounts credited to such reserves each year, provided that the amounts deductible on account of the reserves shall approximate as nearly as can be determined, the actual amounts which experience has demonstrated would be necessary to discharge the liabilities incurred during the year and for the payment of which additions to the reserves were made; and provided if it shall be found that the amount credited to any such reserve is in excess of the reasonable or probable needs of the corporation to meet and discharge the liabilities for which the reserve is credited, the excess of such reserves over and above the reasonable or probable [fol. 141] needs for the purpose indicated, shall be at once disallowed as a deduction and restored to income for the purpose of the tax; and provided further, that in no event will sinking funds or other reserves set up to meet additions, betterments or other capital obligations, constitute allowable deductions from gross income.

"This ruling contemplates that the income and authorized deductions shall be computed and accounted for on the same basis, and that the same practice shall be consistently followed year after year. Amounts paid in discharge of any liability or obligation for which a reserve has been set up, as hereinbefore outlined, will, when paid, be charged to the reserve created to meet it, in so far as such reserve is sufficient to meet the liability, provided always that the liability is of a character, which constitutes an allowable deduction within the meaning of the law.

"If, upon investigation, it shall be found that returns made upon the basis of accruals and reserves, do not reflect the true net income, the corporation so failing in this way to return the true net income, will not thereafter be per-

mitted to make its returns upon any basis other than that of actual receipts and disbursements.

"The reserves contemplated by the foregoing ruling, are those reserves only, which are set up to meet some actual liability incurred, the amount necessary to discharge which can not at the time be definitely determined, and do not contemplate reserves to meet losses contingent upon shrinkage in values, losses from bad debts, capital investments, etc., which losses are deductible only when definitely determined as the result of a closed or completed transaction, and are charged off."

T. D. 2625:

December 17, 1917.

"To Collectors of Internal Revenue:

"The income tax law of October 3, 1913, imposes a tax 'upon the entire net income arising or accruing from all sources during the preceding calendar year to every corporation, joint stock company or association, and every insurance company, organized in the United States, no matter how created or organized."

"Under Section 13(d) of the Act of Congress approved September 8, 1916, it is provided:

[fol. 142] 'A corporation, joint-stock company or association or insurance company, keeping accounts upon any basis other than that of actual receipts and disbursements, unless such other basis does not clearly reflect its income, may, subject to regulations made by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, make its return upon the basis upon which its accounts are kept, in which case the tax shall be computed upon its income as so returned.'

"These provisions of law authorize corporations and joint-stock companies, or associations, and insurance companies, keeping books of account on an accrued basis, to deduct from gross income in returns of annual net income the accrual of interest for the return year within the limits prescribed by the taxing acts when shown as a charge against accrued income upon the books of account."

"Regulations 33, Rev. Art. 191. Taxes Deductible.—Taxes imposed against a corporation by authority of the

United States (except income and excess-profits taxes) its territories or any foreign country, or by authority of any State, county, school district, municipality, or other taxing sub-division of a State (not including those assessed against local benefits) and paid within the year for which the return is made, are deductible from the gross income of a domestic corporation."

[fol. 143] In United States District Court

Petition for Writ of Error—Filed Jan. 25, 1928

Now comes The Aluminum Castings Company, the plaintiff herein, and says that on or about December 20, 1927, this court rendered a judgment in this cause in favor of the defendant and against this plaintiff; that on January 21, 1928, this court overruled this plaintiff's motion for a new trial theretofore filed in this cause; and that in said judgment and the proceedings heretofore had in this cause certain errors were committed, to the prejudice of this plaintiff, all of which will more fully appear from the Assignment of Errors which is filed with this petition.

Wherefore this plaintiff prays for the issuance of a Writ of Error out of the United States Circuit Court of Appeals for the Sixth Judicial Circuit for the correction of the errors so complained of; that a transcript of the record and proceedings and papers in this cause, duly authenticated, may be sent to said United States Circuit Court of Appeals, according to law; and that after due hearing in said United States Circuit Court of Appeals the judgment heretofore rendered herein may be reversed, and judgment rendered in favor of this plaintiff against the defendant in the sum of $166,91[illegible]01, with interest thereon from July 14, 1923, at the rate of six per cent per annum.

M. B. & H. H. Johnson, Attorneys for Plaintiff, The Aluminum Castings Company.

[fol. 144] In United States District Court

Assignments of Errors—Filed Jan. 25, 1928

Now, comes the plaintiff, The Aluminum Castings Company, and says that in the judgment, record and proceed-

ings in this cause there is manifest error, prejudicial to this plaintiff in the following respects, to wit:

(1) The court erred in refusing to find as a special finding of fact the following, and each and every part thereof, to wit:

In the year 1916 the plaintiff made articles from which it derived a profit which was held to be subject to the tax imposed by Title III of the Revenue Act of 1916, and known as the munitions manufacturers' tax. The so-called munitions manufactures' tax of the plaintiff imposed on profits made on munitions manufactured and sold in the year 1916 in the sum of $246,275.63 was paid to the United States Government by the plaintiff in the year 1917. In its federal income tax return for the year 1916 the plaintiff did not deduct from its gross income its said munitions manufacturers' tax of $246,275.63. The plaintiff, in its federal income and profits tax returns filed with the United States Internal Revenue Department for the year 1917, deducted the said munitions manufacturers' tax from its gross income. The Commissioner of Internal Revenue disallowed the said munitions manufacturers' tax of $246,275.63 paid by the plaintiff in the year 1917, as a deduction from the gross income of the plaintiff for the year 1917, and transferred it back as a deduction from the gross income of the plaintiff for the year 1916 in figuring the income and profits taxes of the plaintiff for said years, and also deducted the amount of said munitions manufacturers' tax from the invested capital of the plaintiff for the year 1917. By reason of the said transfer of the munitions manufacturers' tax deduction from the year 1917 to the year 1916 and the said decrease in the plaintiff's invested capital for the year 1917, the federal income and profits taxes of the plaintiff were increased for the year 1917 in the sum of $179,978.86 and decreased for the year 1916 in the sum of $4,925.51, making a net increase of $175,053.35 in said federal income and profits taxes for the years 1916 and 1917 on account of the said transfer of said munitions manufac- [fol. 145] turers' tax deduction from the year 1917 to the year 1916 and said decrease in invested capital, which sum was assessed against the plaintiff. The plaintiff duly filed with the Commissioner of Internal Revenue a claim for refund of the sum of $34,739.06 on account of 1918 income and

profits taxes, and said claim was allowed by said Commissioner of Internal Revenue, but said sum of $34,739.06, instead of being refunded in cash to the plaintiff, was credited by the United States Government $8,050.16 against certain miscellaneous additions to the federal income and profits taxes of the plaintiff for the years 1916 and 1917 (the amount of the said application not being in dispute in this case), and $26,688.90 against the aforesaid additional assessment of income and profits taxes in the sum of $175,053.35 made against the plaintiff for the years 1916 and 1917 on account of the said transfer of the said munitions manufacturers' tax from the year 1917 to the year 1916 and the said decrease of invested capital, leaving a balance of said assessment of $148,364.45. Thereafter Carl F. Routzahn, then Collector of Internal Revenue for the Eighteenth District of Ohio, notified the plaintiff that unless said sum of $148,364.45 and interest thereon amounting to $18,545.56, or a total of $166,910.01, was paid to him on or before July 14, 1923, penalties would be inflicted upon the plaintiff and the property of the plaintiff distrained and sold. Thereupon, to wit, on July 14, 1923, the plaintiff, although maintaining that the collection of said sum of $166,910.01 was illegal, but in order to avoid the distraint and the sale of its property and the imposition of penalties upon it, paid to said Carl F. Routzahn, as Collector of Internal Revenue for the Eighteenth District of Ohio, under protest, the said sum of $166,910.01. Thereafter, to wit, on March 18, 1924, the plaintiff duly filed with the Commissioner of Internal Revenue, according to the provisions of law in that regard and the regulations of the Secretary of the Treasury established in pursuance thereof, a claim for refund of $193,598.91, together with interest thereon, being the sum of the $166,910.01 assessed and collected as aforesaid and the $26,688.90 assessed and credited as aforesaid against [fol. 146] the aforesaid additional assessment of federal income and profits taxes for the years 1916 and 1917. Thereafter, to wit on January 8, 1925, said Commissioner of Internal Revenue rendered a decision rejecting and disallowing said claim for refund.

(2) The court erred in refusing to find as a special finding of fact the following, and each and every part thereof, to wit:

During the years 1916 and 1917 and previous thereto, the entries in the plaintiff's books of account were made as follows: The entries in some accounts were made on the so-called "accrual basis"; the entries in some accounts were made on the basis of actual cash receipts and disbursements; and the entries in some accounts were made when the invoices of the items were made out or received by the plaintiff.

(3) The court erred in refusing to find as a special finding of fact the following, and each and every part thereof, to wit:

Under the United States Revenue Act of 1913, income tax returns could not be made otherwise than on the basis of actual receipts and disbursements, and the regulations issued by the Commissioner of Internal Revenue specifically provided that reserves for taxes could not be allowed, and that interest and taxes could be deducted from gross income only in the year when actually paid; but the regulations issued by the Commissioner of Internal Revenue required that the gross income of manufacturing companies should consist of the total sales of manufactured goods during the year covered by the return, increased or decreased by the gain or loss as shown by the inventories of finished and unfinished products, raw material, etc. at the beginning and end of the year, and the Commissioner of Internal Revenue ruled that accounts and bills receivable of a corporation were to be treated as income for the year in which they were created, that is to say, in the year in which the accounts were set up on the books or the bills receivable were accepted, and that accounts payable, representing the ordinary and necessary expenses of maintaining [fol. 147] and operating the corporation's business and property, might be deducted from the gross income of the year in which the expenses were incurred.

(4) The Court erred in refusing to find as a special finding of fact the following, and each and every part thereof, to wit:

On September 14, 1916, after the enactment of the United States Revenue Act of 1916, the Commissioner of Internal Revenue issued the following ruling:

"Pending the adoption and promulgation of special regulations under the Act of September 8, 1916, Income Tax

Regulations in force September 8, 1916, are hereby extended and made applicable to the act of September 8, 1916, so far as not inconsistent with the provisions of that statute."

(5) The Court erred in refusing to find as a special finding of fact the following, and each and every part thereof, to wit:

On January 8, 1917, the Commissioner of Internal Revenue made the following ruling:

"Sub-paragraph (d) of Sec. 13, of Title I, of the Act of September 8, 1916, provides that

'A corporation, joint stock company or association, or insurance company, keeping accounts upon any basis other than that of actual receipts and disbursements, unless such other basis does not clearly reflect its income, may, subject to regulations made by the Commissioner of Internal Revenue with the approval of the Secretary of the Treasury, make its returns upon the basis upon which its accounts are kept, in which case the tax shall be computed upon its income as so returned.'

Under this provision it will be permissible for corporations which accrue on their books monthly or at other stated periods, amounts sufficient to meet fixed annual or other charges, to deduct from their gross income the amounts so accrued, provided such accruals approximate as nearly as possible the actual liabilities for which the accruals are made, and provided that in cases wherein [fol. 148] deductions are made on the accrual basis as hereinbefore indicated, income from fixed and determinable sources accruing to the corporations must be returned, for the purpose of the tax, on the same basis.

* * * * * * * *

This ruling contemplates that the income and authorized deductions shall be computed and accounted for on the same basis, and that the same practice shall be consistently followed year after year. * * *

If, upon investigation, it shall be found that returns made upon the basis of accruals and reserves, do not reflect the true net income, the corporation so failing in this way to return the true net income, will not thereafter be per-

mitted to make its returns upon any basis other than that of actual receipts and disbursements."

(6) The court erred in refusing to find as a special finding of fact the following, and each and every part thereof, to wit:

The Internal Revenue Department's rulings and regulations hereinabove set forth remained unchanged down to and after July 12, 1917, the date when the plaintiff's amended income tax return for the year 1916 was executed.

(7) The court erred in refusing to find as a special finding of fact the following, and each and every part thereof, to wit:

On account of the plaintiff's bookkeeping department being behind in its work, the plaintiff was obliged, in the first instance, to file a tentative inaccurate return of income for the year 1916, and as soon as correct figures were available, to wit, in July, 1917, the plaintiff filed an amended income tax return for 1916 which was made up by the plaintiff's Secretary and auditor in conjunction with a government auditor who was then at the plaintiff's plant auditing the figures for the plaintiff's income tax return and munitions manufacturers' tax return for the year 1916. A copy of the plaintiff's income tax return and amended income tax return for the year 1916, marked respectively Exhibits A and B, are hereto attached and made a part hereof.

[fol. 149] (8) The court erred in refusing to find as a special finding of fact the following, and each and every part thereof, to wit:

The plaintiff's amended income tax return for the year 1916 was made out as follows: The gross income from operations was figured in the method provided for by the form of Item 3 on the reverse side of the income tax return blank furnished by the Internal Revenue Department, and the plaintiff's ordinary bills and accounts receivable and payable, arising from its manufacturing operations, were treated as cash receipts and disbursements on the dates when they were entered on the books, and the other items,

including rentals and interest and taxes, were actual cash receipts and disbursements during the year.

(9) The court erred in refusing to find as a special finding of fact the following, and each and every part thereof, to wit:

The plaintiff's amended income tax return for the year 1916 figured the income differently from the income shown in the plaintiff's books of account, in that, subject to the method of figuring gross income from operations and the treatment of ordinary bills and accounts receivable and payable arising from the plaintiff's manufacturing operations hereinabove stated, the accruals and reserves on the plaintiff's books of account were omitted in figuring the plaintiff's income tax return. The taxes paid by the plaintiff during the year 1916 amounted to $26,493.44, and the taxes accrued or for which reserves were set up on the plaintiff's books during the year 1916, amounted to $130,924.19.

(10) The court erred in refusing to find as a special finding of fact the following, and each and every part thereof, to wit:

The plaintiff made out its amended income tax return for the year 1916 in the same way as it had done the previous year, and did not elect to avail itself of the privilege granted by Section 13 (d) of the Act of September 8, 1916, to make its return upon the basis upon which its accounts were kept, unless the filing of said return, in itself, constituted such election.

[fol. 150] (11) The court erred in refusing to find as a special finding of fact the following, and each and every part thereof, to wit:

The plaintiff's amended income tax return for the year 1916 was audited and approved, as filed, by the Internal Revenue Department, and this audit and approval has never since been modified or questioned by the Internal Revenue Department except as to the one item of the munitions manufacturers' tax deduction.

(12) The court erred in refusing to find as a special finding of fact the following, and each and every part thereof, to wit:

The munitions manufacturers' taxes of the plaintiff were never accrued on its books, nor were any reserves ever set up against its munitions manufacturers' taxes. The first entry with reference to the munitions manufacturers' tax, which appears on the plaintiff's books, was in July, 1917, when the payment of the tax was entered on the plaintiff's books on the date when it was actually paid.

(13) The court erred in refusing to find as a special finding of fact the following, and each and every part thereof, to wit:

On December 17, 1917, the Commissioner of Internal Revenue issued the following ruling:

"These provisions of law (Sec. 13 (d) of the act of September 8, 1916) authorize corporations and joint stock companies, or associations, and insurance companies, keeping books of account on an accrued basis, to deduct from gross income in returns of annual net income the accrual of interest for the return year within the limits prescribed by the taxing acts when shown as a charge against accrued income upon the books of account."

There were no other pertinent income tax rulings made prior to March, 1918, when the income tax returns for the year 1917 had to be filed, Article 191 of Regulations 33, as it stood in March, 1918, reading as follows:

"Art. 191. Taxes Deductible.—Taxes imposed against a corporation by authority of the United States (except [fol. 151] income and excess-profits taxes) its territories or any foreign country, or by authority of any State, county, school district, municipality, or other taxing subdivision of a State (not including those assessed against local benefits) and paid within the year for which the return is made, are deductible from the gross income of a domestic corporation."

(14) The court erred in refusing to find as a special finding of fact the following, and each and every part thereof, to wit:

The plaintiff made up its income tax return for the year 1917 in the same way that it had made up its income tax return for the year 1916, and did not elect to avail itself of the privilege granted by Section 13 (d) of the Act of September 8, 1916, to make its return upon the basis upon which its accounts were kept, unless the filing of said return, in itself, constituted such election. A copy of plaintiff's income and profits tax returns for the year 1917, marked respectively Exhibits C and D, are hereto attached and made a part hereof.

(15) The Court erred in finding as a special finding of fact the following, and each and every part thereof, to wit:

The Commissioner of Internal Revenue, upon audit and investigation of the plaintiff's books and corporation income and excess profits tax return, determined that the said munitions tax was a proper deduction for the year 1916. He, therefore, disallowed said deduction for the year 1917, which resulted in an additional income and profits tax for the year 1917, in the sum of $179,978.86, and an overassessment for the year 1916 in the sum of $4,925.51, making a net increase of $175.053.35. That by reason of a loss sustained in the year 1919, which, by statute, could be considered as a deduction for the year 1918, the Commissioner of Internal Revenue determined that there should be refunded to this plaintiff the sum of $34,739.06, on the tax paid for the year 1918. This amount was refunded to the plaintiff by credit against the sum of $175,053.35. The plaintiff admits that of this credit of $34,739.06, $8,050.16 was properly applied. The deduction of the remaining [fol. 152] $26,688.90 of the said refund for 1918, which is not involved here, from the net additional tax of $175,053.35, leaves a balance of $148,364.45, which, together with interest paid at the time of payment of the tax in the sum of $18,545.56, makes a total of $166,910.01.

(16) The court erred in finding as a special finding of fact the following, and each and every part thereof, to wit:

That during the years 1916 and 1917 plaintiff kept its accounts upon a basis other than that of actual receipts and disbursements, commonly known as an accrual basis.

(17) The court erred in finding as a special finding of fact the following, and each and every part thereof, to wit:

That for the year 1916 the corporation income tax return, and for the year 1917 the corporation income tax return and excess profit tax return of plaintiff were made, returned, and filed on the basis on which its accounts were kept as aforesaid, viz., an accrual basis.

(18) The court erred in holding that in determining the taxable net income of this plaintiff for the year 1916 the deduction of munitions tax for that year in the sum of $246,275.63 was properly made and in conformity with law.

(19) The court erred in failing and refusing to hold that in determining the taxable net income of this plaintiff for the year 1917 this plaintiff could deduct from its gross income for said year 1917 the munitions tax paid by this plaintiff in said year 1917 in the sum of $246,275.63.

(20) The court erred in entering judgment for the defendant.

(21) The court erred in overruling this plaintiff's motion for new trial.

(22) The court erred in failing and refusing to enter judgment for this plaintiff in the sum of $166,910.01, with interest thereon from July 14, 1923, at the rate of 6% per annum.

Wherefore the plaintiff, The Aluminum Castings Company, prays that the judgment of the District Court of the United States for the Northern District of Ohio, East- [fols. 153 & 154] tern Division, in this cause be reversed, and that judgment be entered in favor of this plaintiff and against the defendant in the sum of $166,910.01, with interest thereon from July 14, 1923, at the rate of 6% per annum.

M. B. & H. H. Johnson, Attorneys for Plaintiff,
The Aluminum Castings Company.

IN UNITED STATES DISTRICT COURT

ORDER ALLOWING WRIT OF ERROR—Jan. 26, 1928

This day, to wit, January 26, 1928, the plaintiff came, by its attorneys, and filed herein and presented to the Court its petition praying for the allowance of a writ of error and an assignment of errors intended to be urged by it, praying that a transcript of the record and proceeding and papers upon which the judgment herein was rendered, duly authenticated, may be sent to the United States Circuit Court of Appeals for the Sixth Judicial Circuit, and that such other and further proceedings may be had as may be proper in the premises.

On consideration whereof, the Court does allow the writ of error upon the plaintiff's giving bond according to law in the sum of $500.00.

Bond on writ of error for $500.00 approved and filed Jan. 30, 1928, omitted in printing.

[fol. 155] IN UNITED STATES DISTRICT COURT

WRIT OF ERROR—Filed Jan. 30, 1928

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

UNITED STATES OF AMERICA,
Sixth Judicial Circuit, ss:

The President of the United States to the Honorable the Judge of the District Court of the United States for the Northern District of Ohio, Greeting:

Because in the record and proceedings, as also in the rendition of the judgment of a plea which is in the said District Court, before you, or some of you, between The Aluminum Castings Company as plaintiff and Carl F. Routzahn, Individually and as Collector of Internal Revenue, as defendant, a manifest error hath happened, to the great

damage of the said The Aluminum Castings Company as by its complaint appears. We being willing that error, if any hath been, should be duly corrected, and full and speedy justice done to the parties aforesaid in this behalf, do command you, if the judgment be therein given, that then under your seal, distinctly and openly, you send the record and proceedings aforesaid, with all things concerning the same, to the United States Circuit Court of Appeals for the Sixth Circuit, together with this writ, so that you have the same at Cincinnati, in said Circuit, on the* 29th day of February, next, in the said Circuit Court of Appeals to be then and there held, that the record and proceedings aforesaid being inspected, the said Circuit Court of Appeals may cause further to be done therein to correct that error, what of right, and according to the laws and customs of the United States should be done.

Witness the Honorable William Howard Taft, Chief Justice of the United States, the 30th day of January, in the year of our Lord one thousand nine hundred and twenty-eight, and of the Independence of the United States of America the one hundred and fifty-second.

B. C. Miller, Clerk of the District Court of the United States for the Northern District of Ohio, by F. J. Denzler, Deputy Clerk. (Seal.)

[fol. 156] Allowed by D. C. Westenhaver, Judge of the District Court.

Return on Writ of Error

United States of America,
Northern District of Ohio, ss:

In pursuance to the command of the within writ of error, I, B. C. Miller, Clerk of the United States District Court within and for said District, do herewith transmit under the seal of said court, a full, true and complete copy of the record and proceedings of said court in the cause and matter in said writ of error stated, together with all things concerning the same, in accordance with the precipe filed,

*Not exceeding 30 days from the day of signing the citation.

to the United States Circuit Court of Appeals for the Sixth Circuit.

There is annexed hereto and made part of this return the writ of error and citation to said defendant in error.

Witness my official signature and the seal of said court, at Cleveland, in said District, this — day of ——, A. D. 192 . , and in the 15 . . year of the Independence of the United States of America.

—— ——, Clerk, by —— ——, Deputy Clerk.

[fols. 157 & 158] Citation, in usual form, showing service on A. E. Bernsteen, omitted in printing.

[fol. 159] In United States District Court

Stipulation re Certification of Record—Filed Jan. 25, 1928

In accordance with Section 7 of Rule 44 of the general rules of this Court, it is hereby agreed that the record as presented to the Clerk by the printer, may be certified by the Clerk as required by law and the rules of the Appellate Court, as a true, full and complete copy of the original pleadings, papers and orders used on the trial of this cause, as set forth in the precipe for transcript, without further comparison by the clerk.

M. B. & H. H. Johnson, Attorneys for Plaintiff.
A. E. Bernsteen, Attorney for Defendant.

[fol. 160] In United States District Court

Precipe for Transcript—Filed Jan. 31, 1928

To the Clerk:

Please prepare transcript of record for the Circuit Court of Appeals in the above entitled cause, and include therein the following papers and orders:

Amended petition filed November 10, 1926.

Answer to amended petition filed November 20, 1926.

Waiver of jury filed November 11, 1927, and journal entry of same date showing progress of trial.

Defendant's Request for Findings of Fact and Conclusions of Law filed November 23, 1927.

Memorandum opinion of Court filed November 30, 1927.

Plaintiff's Request for Special Findings of Fact filed December 10, 1927.

Memorandum settling Findings of Fact filed December 16, 1927.

Journal entry including Findings of Fact, Conclusions of Law and Judgment filed December 20, 1927.

Motion for New Trial filed December 20, 1927.

Order overruling Motion for New Trial entered January 21, 1928.

Order approving narrative form of Bill of Exceptions.

Narrative form of Bill of Exceptions.

Petition for Writ of Error.

Assignment of Errors.

Order allowing Writ of Error.

Bond on Writ of Error.

Writ of Error.

Return on Writ of Error.

Citation and return thereon.

Stipulation re certification of record.

Precipe for transcript.

Certificate of clerk.

And deliver all papers to The Gates Legal Publishing Company for Printing.

M. B. & H. H. Johnson, Attorneys for Plaintiff.

[fols. 161 & 162] ACKNOWLEDGMENT OF SERVICE

Service of a copy of the above and foregoing precipe is hereby acknowledged January 31, 1928.

A. E. Bernsteen, Attorney for Defendant.

In United States District Court

Order Extending Time for Filing Transcript of Record—Feb. 29, 1928

On application of plaintiff and for good cause shown, it is ordered that the time for filing the transcript of record in the United States Circuit Court of Appeals be extended to March 30, 1928.

[fols. 163 & 164] Clerk's certificate to foregoing transcript omitted in printing.

[fol. 165] Appearance of counsel omitted in printing.

Minute entry of argument and submission February 11, 1929, omitted in printing.

In United States Circuit Court of Appeals, Sixth Circuit

Judgment—Filed April 2, 1929

Error to the District Court of the United States for the Northern District of Ohio.

This cause came on to be heard on the transcript of the record from the District Court of the United States for the Northern District of Ohio, and was argued by counsel.

On Consideration Whereof, It is now here ordered and adjudged by this Court, that the judgment of the said District Court in this cause be and the same is hereby affirmed.

[fol. 166] In United States Circuit Court of Appeals

Opinion—Filed April 2, 1929

Before Moorman, Hicks, and Hickenlooper, Circuit Judges

Hickenlooper, Circuit Judge:

This is an action to recover income taxes paid under protest. In the years 1916 and 1917 plaintiff was engaged in

the manufacture of aluminum, brass and bronze castings, including certain munitions of war manufactured in 1916 and subject to the munitions tax. (Title III, Revenue Act 1916, 39 Stat. 780.) Such munitions tax was not payable and was not paid until within the calendar year 1917. Section 12 (a) of the Revenue Act of 1916 (c. 463, 39 Stat. 767-8-9) prescribed the method for ascertaining the net income of a corporation organized in the United States, by deducting from the gross amount of its income received within the year from all sources, first, all ordinary and necessary expenses paid within the year; second, all losses actually sustained and charged off within the year and not compensated by insurance or otherwise; third, the amount of interest paid within the year on its indebtedness not exceeding the proportions fixed; and fourth, taxes paid within the year. The method so outlined is usually referred to as the cash receipt and disbursement basis of return. Section 13 (d) of the same act (39 Stat 771) further provided that a corporation keeping accounts upon any basis other than that of actual receipts and disbursements, unless such other basis does not clearly reflect its income, may, subject to regulations made by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, make its return upon the basis upon which its accounts are kept, in which case the tax shall be computed upon its income as so returned. This is ordinarily denominated a return upon the accrual basis.

In preparing its returns for income tax for the years 1916 and 1917 plaintiff declared therein that the return was made on the basis of actual receipts and disbursements but included in its gross income from operations the in- [fol. 167] crease in inventory value of stock on hand and accounts receivable as of the date of entry upon the books without regard to whether such accounts were actually paid or not. In the deductions claimed accounts payable were treated as expenditures as of the time of entry upon the books. Depreciation of buildings and equipment was likewise claimed. Other reserves appearing upon the books were not reflected in the return. Only such taxes as were actually paid during the year were deducted. The books of the corporation were kept upon the "accrual" basis except that no reserve was set up during 1916 to cover

the munitions tax and the amount of this tax was not claimed as a deduction in the return for 1916 but was set up on the books in, and claimed as a deduction for, the year 1917, in which year it was actually paid. The Commissioner of Internal Revenue audited the returns for 1916 and 1917, disallowed the munitions tax as a deduction for the year 1917 and allocated the same to the year 1916 as properly attributable to that period. This transfer of the munitions tax as a deduction from the year 1917 to the year 1916 increased the taxes payable for said years by the sum of $166,910.90. The District Court found for the defendant. 24 F. (2d) 230. Plaintiff prosecutes error.

Since all facts are conceded and only the conclusions to be drawn therefrom are contested, the ultimate and decisive question presented is whether the returns of plaintiff for the years 1916 and 1917 were on a strictly cash receipt and disbursement basis under section 12 (a) or upon some other basis under section 13 (d). As held by the District Court, we are of the opinion that the case is controlled by the decision of U. S. v. Anderson et al., 269 U. S. 422, which case was later cited and approved in U. S. v. Mitchell, 271 U. S. 9, 12; American National Co. v. U. S., 274 U. S. 99, 103; and Reinecke, Collector v. Gardner, 277 U. S. 239, 244. These cases authoritatively establish "that if the taxpayer keeps his books on any basis other than that of actual receipts and disbursements, and the return is made on the basis adopted, the tax shall be computed on that basis unless the books clearly do not [fol. 168] reflect the taxpayer's true income." In fact, as said in U. S. v. Anderson, supra, p. 440, the combined effect of sections 12 (a) and 13 (d) of the act of 1916 is "to require the tax return to be made on that basis, if the taxpayer failed or was unable to make the return on a strict receipts and disbursements basis."

Manifestly the books of all corporations owning large properties and doing an extensive business must of necessity be kept upon other than a cash receipt and disbursement basis if such books are to reflect the true financial condition of the company. A strict cash receipt and disbursement basis of accounting contemplates that only such receipts and disbursements as were in fact received or paid out during the calendar year shall enter into the re-

turn, not such credits or debits as may have been created but not discharged. Such cash receipt and disbursement basis further contemplates that loss or gain shall enter into the return only for that calendar or fiscal year in which such loss or gain is definitely determined and actually suffered or realized, rather than accrued or reflected in decrease or increase in values. These principles lead inevitably to the conclusion that the items of increase in inventory value, of depreciation of buildings and equipment and of accounts receivable and payable, are not upon the cash receipt and disbursement basis and convert the return, at least, pro tanto, to one upon some other basis, within the letter of section 13 (d).

It is objected that prior to 1916 no other basis for return was recognized than that upon cash receipt and disbursement basis; that the internal revenue regulations then definitely recognized and established that differences in inventory value, accounts receivable and payable created during the year, and depreciation, were proper items for inclusion in a return upon the cash receipt and disbursement basis and were recognized as cash items; that section 13 (d) did not vary this prior practice but, the regulations and requirements of the Department remaining unchanged, simply gave to the taxpayer the option of making its return upon an accrual basis; that these items thus continued and remained proper "cash items" in a receipt [fol. 169] and disbursement return unless the taxpayer had elected to make return upon some other basis; and that this plaintiff has definitely refused to so exercise such option. These contentions are likewise answered by the case of United States v. Anderson, supra, at pp. 439, 440. The difficulty if not the utter impossibility of preparing a return upon a strict basis of receipts and disbursements in most cases constituted at once the reason and necessity for the enactment of section 13 (d). The mere fact that by the prior law a return upon the basis of receipts and disbursements was alone recognized and required and the fact that, for reasons of necessity and expediency and in order that the return might truly reflect the income of the taxpayer, the department was driven to permit and require the use of accrual items in then making such returns, do not irrevocably classify such items

as actual receipts and disbursements or preclude return to and application of correct definition when the machinery therefor is provided.

We therefore hold that the court below did not err in its conclusion that the returns of plaintiff for the years 1916 and 1917 were made upon the accrual basis. If this be considered a finding of fact, as treated by the lower court, there was ample evidence to support such finding and this court is bound thereby. If considered as presenting a question of law, or a mixed question of law and fact, no error is apparent. It is conceded that the books were kept upon an accrual basis, at least in substantial measure. Where the books are so kept and the return so made, the decision of U. S. v. Anderson and the other authorities cited are conclusive upon the issue that the Commissioner of Internal Revenue was right in allocating the munitions tax to the return of 1916 and in eliminating it as a deduction in the return of 1917. Whether adjustments should also have been made for other accruals and reserves appearing upon the books, but not carried into the return, is a question not here and now presented.

The judgment is affirmed.

[fol. 170] Clerk's certificate to foregoing transcript omitted in printing.

[fol. 171] SUPREME COURT OF THE UNITED STATES

ORDER ALLOWING CERTIORARI—Filed October 21, 1929

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Sixth Circuit is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

Endorsed on cover: File No. 34,329. U. S. Circuit Court of Appeals, Sixth Circuit. Term No. 198. The Aluminum Castings Company, petitioner, vs. Carl F. Routzahn, individually and as Collector of Internal Revenue. Petition for writ of certiorari and exhibit thereto. Filed June 26th, 1929. File No. 34,329.

FILE COPY

FILED
JUN 26 1929
CHARLES ELMORE CROPLEY
CLERK

In the Supreme Court of the United States

OCTOBER TERM, 1928.

No. ~~3~~ 7

THE ALUMINUM CASTINGS COMPANY,

Petitioner,

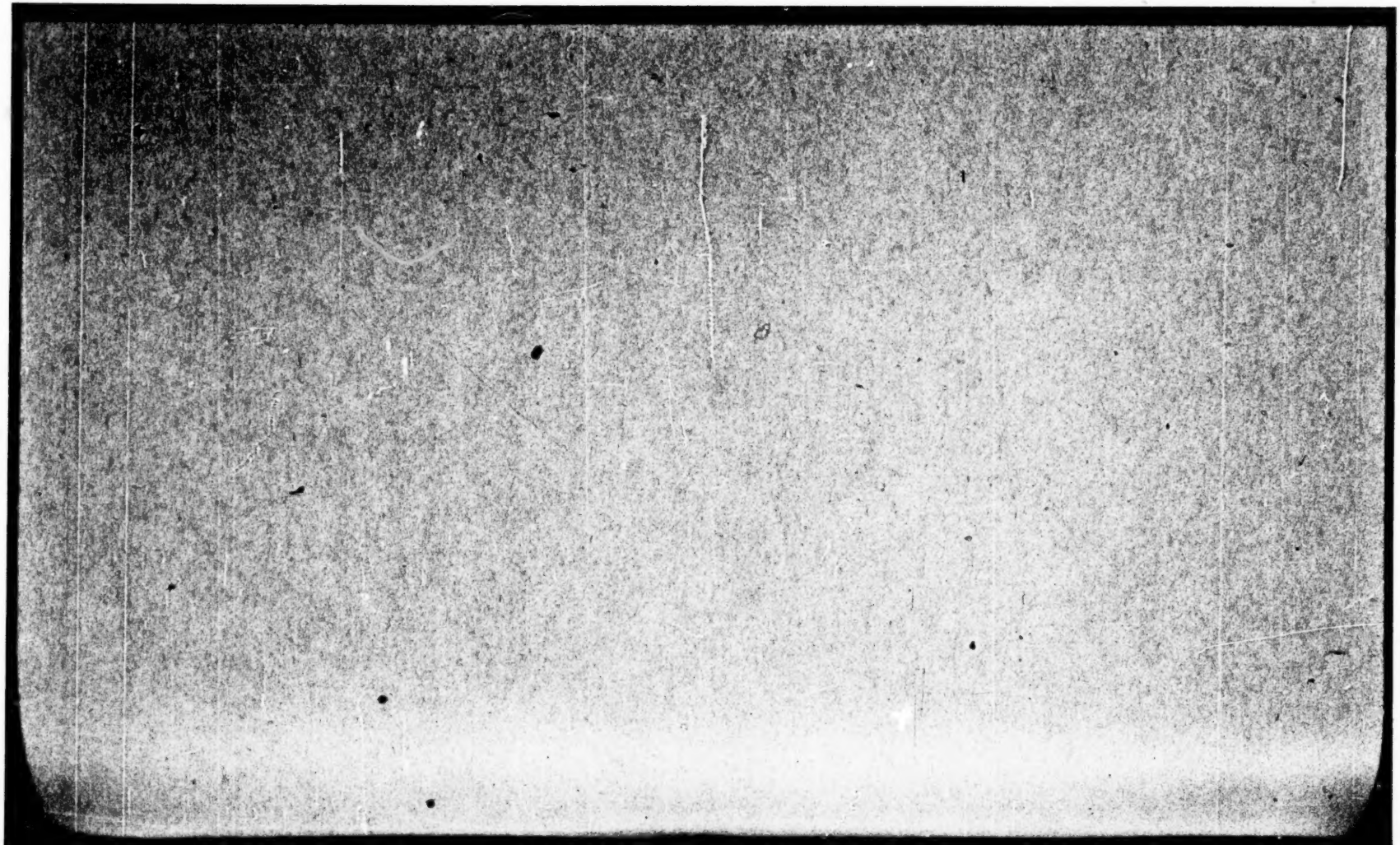
vs.

CARL F. ROUTZAHN, Individually and as Collector of Internal Revenue,

Respondent.

PETITION FOR WRIT OF CERTIORARI
To the United States Circuit Court of Appeals
For the Sixth Circuit and
BRIEF IN SUPPORT THEREOF.

JOHN T. SCOTT,
Counsel for Petitioner.



In the Supreme Court of the United States

OCTOBER TERM, 1928.

No. .....

THE ALUMINUM CASTINGS COMPANY,

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PETITION FOR WRIT OF CERTIORARI
To the United States Circuit Court of Appeals
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JOHN T. SCOTT,
Counsel for Petitioner.

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In the Supreme Court of the United States

OCTOBER TERM, 1928.

No. .....

THE ALUMINUM CASTINGS COMPANY,
Petitioner,

vs.

CARL F. ROUTZAHN, Individually and as Collector of Internal Revenue,
Respondent.

PETITION FOR WRIT OF CERTIORARI.

May It Please the Court:

The petition of The Aluminum Castings Company respectfully shows to this Honorable Court:

Summary and Short Statement of the Matter Involved.

The petitioner in the year 1917 paid a United States munitions manufacturers' tax in the sum of $246,275.63, which was due and payable in the year 1917 but imposed on profits made on munitions manufactured and sold in the year 1916. In making out its Federal income tax returns, the petitioner deducted the said munitions manufacturers' tax from its gross income for the year 1917 and the Commissioner of Internal Revenue disallowed the deduction for the year 1917 and transferred it back as a deduction for the year 1916. If this action is incorrect, the petitioner is admittedly entitled to recover from the respondent in this suit the sum of $166,910.01, together with interest thereon from

July 14, 1923, at the rate of 6% per annum. (See Stipulation of Facts, Record, pp. 30-32.)

The petitioner made out its income tax returns for the years 1916 and 1917 as actual receipt and disbursement returns, in exact and complete compliance with the Treasury Department rules and regulations then governing actual receipt and disbursement returns, and the petitioner expressly stated in its income tax return for each of these years that the tax return was made on the basis of actual receipts and disbursements, it being added in the 1917 return that bills and accounts payable and receivable are treated as receipts and disbursements (See Record, pp. 33-41, 69, 73, 80, 93 and 98). The Treasury Department rules and regulations, as well as the income tax blanks issued pursuant thereto, then obliged manufacturing companies, in making out actual receipt and disbursement returns, to figure gross income by the use of inventories, and to treat bills and accounts receivable and payable, representing sales of products and purchases of materials and other costs of goods, as actual receipts and disbursements, on the dates when set up on the books (See Record, pp. 138-139, 142, 69, 73, 87 and 93). These rules and regulations the petitioner obeyed (See Record, pp. 35 and 39). It is now claimed by the respondent, and it has been held by the lower courts in this case, that such use of inventories and treatment of such bills and accounts receivable and payable, as then required by the Treasury Department rules and regulations governing actual receipt and disbursement returns, conclusively made the returns "accrual" returns, and constituted an election on the part of the petitioner to make "accrual" returns under Section 13 (d) of the Revenue Act of 1916, so that the munitions manufacturers' tax had to be accrued and deducted in the year 1916. In all respects (including the items of rentals, interest and taxes) other than the use of inventories and the treatment of ordi-

nary bills and accounts receivable and payable, arising out of its manufacturing operations, as cash receipts and disbursements, the petitioner's income tax returns were unquestionably strict actual receipt and disbursement returns (See Record, pp. 33-41). All reserves and accruals which were set up on the petitioner's books (subject to the controverted question above mentioned as to the use of inventories and the treatment of certain accounts and bills receivable and payable), including all accruals of taxes, were disregarded in making out the petitioner's income tax returns (See Record, pp. 34, 36, 37 and 38).

The entries in the petitioner's books of account were made as follows: The entries in some accounts were made on the so-called "accrual" basis, the entries in some accounts were made when the invoices of the items were made out or received by the petitioner, and the entries in some accounts were made on the basis of cash receipts and disbursements (See Record, pp. 34, 36, 41, 42 and 47). The petitioner's munitions manufacturers' taxes were never accrued on its books of account, nor were any reserves ever set up against its munitions manufacturers' taxes (See Record, p. 31).

The petitioner contends that Section 12 (a) of the Internal Revenue Law of 1916, like the similar provisions in the Internal Revenue Law of 1913, provided for actual receipt and disbursement returns; that Section 13 (d) of the Internal Revenue Law of 1916 merely gave an option to a corporation keeping accounts on any basis other than that of actual receipts and disbursements, to make its income tax returns on the basis on which its accounts were kept; that petitioner's income tax returns for the years 1916 and 1917 were made on the basis of actual receipts and disbursements, as then defined by the regulations and rulings issued by the Treasury Department, and in exact conformity with the Treasury Department's regulations and rulings then

governing actual receipt and disbursement returns, and thereunder the petitioner's taxes could be properly deducted only in the year when actually paid; that the petitioner never exercised its option to avail itself of the provisions of Section 13 (d) of the Internal Revenue Act of 1916, granting it the privilege of making its income tax returns on the basis on which its accounts were kept; that even if it was improper for the petitioner in an actual receipt and disbursement return to use inventories in figuring its gross income from operations, and to treat accounts receivable and payable arising out of its manufacturing operations as cash receipts and disbursements on the dates when they were entered on its books, as was then required in actual receipt and disbursement returns by the regulations and rulings of the Treasury Department, yet the income tax returns, having been avowedly made on the actual receipt and disbursement basis, and having been made in exact conformity with the regulations and rulings of the Commissioner of Internal Revenue then governing actual receipt and disbursement returns, the only correction, if any, that the Commissioner of Internal Revenue could properly have made, if the Treasury Department had subsequently changed its regulations and rulings governing actual receipt and disbursement returns, was to correct the income tax returns on the basis on which they were intended to be made, to wit, the actual receipt and disbursement basis. The petitioner further contends that even if we assume that the petitioner had elected to make its income tax returns for the years 1916 and 1917 on the same basis on which its accounts were kept, the munitions manufacturers' tax would not have been deducted in the year 1916 but in the year 1917; for the petitioner's accounts were kept on such basis that the petitioner's munitions manufacturers' tax account was entered on its books only on an actual disbursement basis and not on an accrual basis.

The lower courts have decided against the petitioner on the ground that the opinion of this Court in the cases of *United States v. Anderson* and *United States v. Yale & Towne Manufacturing Company* lays down the doctrine that Section 13 (d) of the Act of 1916 *requires* the tax return to be made on the "accrual" basis if the taxpayer failed or was unable to make the return on a *strict* receipts and disbursements basis, and that upon proper accounting principles a strict receipts and disbursements return would not allow the use of inventories or the treatment of any bills and accounts receivable and payable as cash receipts and disbursements, and that consequently the case at issue is controlled by the decisions of this Court in the above-mentioned cases. The petitioner maintains that the lower courts have been misled by certain language in the opinion of this Court in the above cited cases into giving the ratio decidendi of those cases a scope which is logically unsound, extremely unjust and unintended by this Court; and the crucial question in the case at issue is the proper construction of this Court's opinion in the above cited cases.

Another case brought by The Aluminum Castings Company against the United States, involving the same identical question as in the case at issue, is now pending in the United States Court of Claims.

Reasons Relied on for the Allowance of the Writ.

1. The Circuit Court of Appeals for the Sixth Circuit has decided an important question of Federal Law which has not been, but should be, settled by this Court.

2. The Circuit Court of Appeals for the Sixth Circuit has decided a Federal question in a way probably in conflict with applicable decisions of this Court.

3. The decision in the case at issue depends upon the proper construction of the opinion of this Court in the

cases of *United States vs. Anderson and United States vs. Yale and Towne Manufacturing Company*, 269 U. S. 422, and upon the true ratio decidendi thereof, and if, as the petitioner maintains, the lower courts have been misled by certain language in the opinion of this Court and misinterpreted the ratio decidendi of those cases, this Court, in the interests of fairness and justice, should settle and clarify the doctrine of those cases and its applicability or nonapplicability to the facts in the case at issue.

4. The decision of the Circuit Court of Appeals for the Sixth Circuit in the case at issue is in conflict with the decision of the Circuit Court of Appeals for the Third Circuit, in the case of *American Can Company vs. United States*, 31 Fed. Rep. (2d) 730.

WHEREFORE, your petitioner respectfully prays that a writ of certiorari be issued out of and under the seal of this Honorable Court, directed to the Circuit Court of Appeals for the Sixth Circuit, commanding that court to certify and to send to this Court for its review and determination, on a day certain to be therein named, a full and complete transcript of the record and all proceedings in the case numbered and entitled on its docket, No. 5134, The Aluminum Castings Company, Plaintiff in Error, vs. Carl F. Routzahn, Individually and as Collector of Internal Revenue, Defendant in Error, and that the said judgment of the Circuit Court of Appeals for the Sixth Circuit may be reversed by this Honorable Court, and that your petitioner may have such other and further relief in the premises as to this Honorable Court may seem meet and just; and your petitioner will ever pray.

THE ALUMINUM CASTINGS COMPANY,

By JOHN T. SCOTT,

Counsel for Petitioner.

In the Supreme Court of the United States

OCTOBER TERM, 1928.

No. .....

THE ALUMINUM CASTINGS COMPANY,
Petitioner,

vs.

CARL F. ROUTZAHN, Individually and as Collector of Internal Revenue,
Respondent.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

I.

OPINIONS OF THE COURTS BELOW.

The opinion of the United States District Court for the Northern District of Ohio, Eastern Division, is reported in 24 Fed. Rep. (2d) 230. The opinion of the United States Circuit Court of Appeals for the Sixth Circuit is reported in 31 Fed. Rep. (2d) 669, and is found in the Transcript of the Record in this case at page 166.

II.

JURISDICTION.

This proceeding is a petition for a writ of certiorari to the United States Circuit Court of Appeals for the Sixth Circuit, filed under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925 (43 Stat. 938). The date of the judgment to be reviewed is April 2, 1929 (See Record, p. 165).

III.

STATEMENT OF THE CASE.

In the year 1916, the petitioner, an Ohio corporation, manufactured articles from which it derived a profit which was held to be subject to the tax imposed by Title III of the Revenue Act of 1916 and known as the munitions manufacturers' tax. The so-called munitions manufacturers' tax of the petitioner, imposed on profits made on munitions manufactured and sold in the year 1916, in the sum of $246,275.63, was paid to the United States Government by the petitioner in the year 1917. In its Federal income tax return for the year 1916, the petitioner did not deduct the said munitions manufacturers' tax from its gross income because said munitions manufacturers' tax was not paid in said year; but, having paid the said munitions manufacturers' tax in 1917, the petitioner deducted said tax from its gross income in its Federal income and profits tax returns filed with the United States Internal Revenue Department for the year 1917. The Commissioner of Internal Revenue disallowed the said munitions manufacturers' tax of $246,275.63, paid by the petitioner in the year 1917, as a deduction from the gross income of the petitioner for the year 1917, and transferred it back as a deduction from the gross income of the petitioner for the year 1916, in figuring the income and profits taxes of the petitioner for said years, and also deducted the amount of said munitions manufacturers' tax from the invested capital of the petitioner for the year 1917. The question at issue in this case is whether this action of the Commissioner of Internal Revenue (which resulted in a net increase of petitioner's Federal income and profits taxes for the years 1916 and 1917 of $175,053.35), was correct or incorrect. If incorrect, the petitioner, under the stipulation of facts made in this case, is admittedly entitled to recover from the respondent in this action the sum of $166,910.01, together with interest

thereon from July 14, 1923, at the rate of 6% per annum. (See Stipulation of Facts, Record, pp. 30-32.)

The case was tried to the District Court, a jury being waived in writing pursuant to the provisions of Section 649 of the Revised Statutes of the United States; and special findings of fact were duly requested by the parties and made by the District Court. (See Record, pp. 9-22 and 25-28.) The District Court rendered judgment for the respondent, which was affirmed by the Circuit Court of Appeals for the Sixth Circuit on April 2, 1929. (See Record, pp. 27 and 165.)

The facts involved in the case at issue are undisputed* and are as follows:

The Internal Revenue Law of 1913 (enacted October 3, 1913) provided as follows (Section G (b)) (38 Stat. 172):

> "Such net income shall be ascertained by deducting from the gross amount of the income of such corporation, joint-stock company or association, or insurance company, received within the year from all sources,
>
> (first) all the ordinary and necessary expenses paid within the year in the maintenance and operation of its business and properties, including rentals or other payments required to be made as a condition to the continued use or possession of property;
>
> (second) all losses actually sustained within the year and not compensated by insurance or otherwise, including a reasonable allowance for depreciation by use, wear and tear of property, if any; * * *
>
> (third) the amount of interest accrued and paid within the year on its indebtedness to an amount of such indebtedness not exceeding one-half of the sum of

*See Record, p. 50, where the District Court said, "I cannot see that you folks differ about anything here as to the real facts," and Record, p. 12, where the District Court in its Memorandum Opinion said, "The facts on which this issue turns, are not really in dispute," and Record, p. 167, where the Circuit Court of Appeals said, "Since all facts are conceded, * * *."

its interest bearing indebtedness and its paid-up capital stock outstanding at the close of the year, or if no capital stock, the amount of interest paid within the year on an amount of its indebtedness not exceeding the amount of capital employed in the business at the close of the year; * * *

(fourth) all sums paid by it within the year for taxes imposed under the authority of the United States or of any State or Territory thereof, or imposed by the Government of any foreign country."

Under the Internal Revenue Law of 1913, the only recognized basis for making income tax returns was that of actual receipts and disbursements (See Law Opinion 1059, Record, pp. 130 and 137, and argument of the Solicitor General, 269 U. S. 423, hereinafter quoted), and thereunder the Commissioner of Internal Revenue made the following rulings:

Regulations 33, Art. 156 (See Record, p. 138):

"Reserves for taxes cannot be allowed, as the law specifically provides that only such sums as are paid within the year for taxes shall be deducted."

Regulations 33, Art. 158 (See Record, p. 138):

"Deductions for taxes, however, should be the aggregate of the amounts actually paid, as shown on the cash book of the corporation."

A similar ruling was made as to interest.

Regulations 33, Art. 148 (See Record, p. 138):

"The interest to be deductible must have been computed on the proper principal at the contract rate and must have been actually paid within the year."

While the United States Internal Revenue Law of 1913 required income tax returns to be made on the actual receipt and disbursement basis and the Regulations issued by the Commissioner of Internal Revenue specifically pro-

vided that reserves for taxes could not be allowed and that interest and taxes could be deducted from gross income only in the year when actually paid, yet the Regulations issued by the Commissioner of Internal Revenue required that the gross income of manufacturing companies should consist of the total sales of manufactured goods during the year covered by the return, increased or decreased by the gain or loss as shown by the inventories of finished and unfinished products, raw material, etc., at the beginning and end of the year, and the Commissioner of Internal Revenue ruled that accounts and bills receivable of a corporation were to be treated as income for the year in which they were created, that is to say, in the year in which the accounts were set up on the books or the bills receivable were accepted, and that accounts payable, representing the ordinary and necessary expenses of maintaining and operating the corporation's business and property, might be deducted from the gross income of the year in which the expenses were incurred.

See Regulations 33, Art. 104 (Record, p. 139), which provides as follows:

> "Gross income of manufacturing companies shall consist of the total sales of manufactured goods during the year covered by the return, increased or decreased by the gain or loss as shown by the inventories of finished and unfinished products, raw material, etc., at the beginning and end of the year."

and letter addressed to Carey, Piper and Hall, Baltimore, Maryland, signed by Acting Commissioner David A. Gates and dated March 2, 1915 (Record, p. 139), wherein the Acting Commissioner says:

> "Accounts payable, representing ordinary and necessary expenses of maintaining and operating the business and property of a corporation, if actually charged into the Expense Account and so entered on the books as to constitute a liability against the assets

of the company, and so treated in the preparation of the return of annual net income that they will not be included in the deductions in the year in which they are actually paid in cash, or its equivalent, such accounts payable may be deducted from the gross income of the year in which the expenses were incurred.

"This ruling applies only to accounts payable representing ordinary and necessary expenses of maintaining and operating the business, that is, to such expenses as are incurred by the corporation in producing the gross income which it is required to return.

"Accounts and bills receivable of a corporation are to be treated as income for the year in which they are created, that is to say, in the year in which the accounts are set up on the books or the bills receivable are accepted."

From the foregoing, it will be seen that the rulings of the Commissioner of Internal Revenue under the Internal Revenue Act of 1913 were that the income tax returns under that law must be made on an actual receipt and disbursement basis, but that manufacturing corporations were not only permitted, but obliged by the method of computing gross income required by Art. 104 of Regulations 33 promulgated by the Commissioner of Internal Revenue, to use inventories and to treat bills and accounts receivable and payable representing sales of products and purchases of materials and other costs of goods as actual receipts and disbursements. In other words, the Commissioner of Internal Revenue ruled that the actual receipt and disbursement basis of figuring and reporting income, required by the Internal Revenue Law of 1913, was not violated by using inventories or by treating bills and accounts receivable and payable arising from its manufacturing operations as actual receipts and disbursements of the dates when they were entered on the company's books.

Pursuant to the foregoing regulations and rulings of the Commissioner of Internal Revenue, the petitioner reported its income for the year 1915, in its Federal income tax return for that year, on the basis of cash receipts and disbursements, using inventories in figuring gross income and treating its ordinary bills and accounts receivable and payable, arising in the operation of its manufacturing business, as cash receipts and disbursements on the dates on which they were entered on the Company's books (See Record, pp. 34 and 36).

On September 8, 1916, a new Federal income tax law was passed. This law contained the following provisions (39 Stat. 767):

> "Sec. 12. (a) In the case of a corporation, joint-stock company or association, or insurance company, organized in the United States, such net income shall be ascertained by deducting from the gross amount of its income received within the year from all sources—
>
> First. All the ordinary and necessary expenses paid within the year in the maintenance and operation of its business and properties, including rentals or other payments required to be made as a condition to the continued use or possession of property to which the corporation has not taken or is not taking title, or in which it has no equity.
>
> Second. All losses actually sustained and charged off within the year and not compensated by insurance or otherwise, including a reasonable allowance for the exhaustion, wear and tear of property arising out of its use or employment in the business or trade; * * *
>
> Third. The amount of interest paid within the year on its indebtedness to an amount of such indebtedness not in excess of the sum of (a) the entire amount of the paid-up capital stock outstanding at the close of the year, or, if no capital stock, the entire amount of capital employed in the business at the

close of the year, and (b) one-half of its interest-bearing indebtedness then outstanding; * * *

Fourth. Taxes paid within the year imposed by the authority of the United States, or its Territories, or possessions, or any foreign country, or under the authority of any State, county, school district, or municipality, or other taxing sub-division of any State, not including those assessed against local benefits."

It will be noted that the above quoted provisions of Section 12(a) of the Internal Revenue Law of September 8, 1916, are substantially identical with the corresponding provisions of Section G(b) of the Internal Revenue Law of 1913 hereinabove quoted.

The Internal Revenue Law of 1916 also provided as follows:

Sec. 13. (39 Stat. 771)

* * * *

"(d) A corporation, joint-stock company or association, or insurance company, keeping accounts upon any basis other than that of actual receipts and disbursements, unless such other basis does not clearly reflect its income, may, subject to regulations made by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, make its return upon the basis upon which its accounts are kept, in which case the tax shall be computed upon its income as so returned;"

On September 14, 1916, W. H. Osborn, Commissioner of Internal Revenue, issued the following ruling (See Record, p. 139):

"Pending the adoption and promulgation of special regulations under the Act of September 8, 1916, Income Tax Regulations in force September 8, 1916, are hereby extended and made applicable to the Act of September 8, 1916, so far as not inconsistent with the provisions of that statute."

On January 8, 1917, the Commissioner of Internal Revenue made the following ruling, T. D. 2433 (See Record, pp. 140-141):

> "Sub-paragraph (d) of Sec. 13, of Title I, of the Act of September 8, 1916, provides that
>
> > 'A corporation, joint stock company or association, or insurance company, keeping accounts upon any basis other than that of actual receipts and disbursements, unless such other basis does not clearly reflect its income, may, subject to regulations made by the Commissioner of Internal Revenue with the approval of the Secretary of the Treasury, make its returns upon the basis upon which its accounts are kept, in which case the tax shall be computed upon its income as so returned.'
>
> "Under this provision it will be permissible for corporations which accrue on their books monthly or at other stated periods, amounts sufficient to meet fixed annual or other charges, to deduct from their gross income the amounts so accrued, provided such accruals approximate as nearly as possible the actual liabilities for which the accruals are made, and provided that in cases wherein deductions are made on the accrual basis as hereinbefore indicated, income from fixed and determinable sources accruing to the corporations must be returned, for the purpose of the tax, on the same basis.
>
> "In cases wherein, pursuant to the consistent practice of accounting of the corporation, * * * corporations set up and maintain reserves to meet liabilities, the amount of which and the date of payment or maturity of which, is not definitely determined or determinable at the time the liability is incurred, it will be permissible for the corporations to deduct from their gross income the amounts credited to such reserves each year, provided that the amounts deductible on account of the reserves shall approximate as nearly as can be determined, the actual amounts which experience has demonstrated would be necessary to

discharge the liabilities incurred during the year and for the payment of which additions to the reserves were made; * * *

* * * *

"If, upon investigation, it shall be found that returns made upon the basis of accruals and reserves, do not reflect the true net income, the corporation so failing in this way to return the true net income, will not thereafter be permitted to make its returns upon any basis other than that of actual receipts and disbursements."

It will be noted that the utmost effect that can be given to Sec. 13(d) of the Act of September 8, 1916, is simply that corporations which have kept their accounts on a basis other than that of actual receipts and disbursements, but have theretofore been obliged by law to report their income on an actual receipt and disbursement basis, are now permitted, if they so desire, to report their income upon the basis upon which they have kept their accounts. Section 13(d), however, in no way compels corporations under any circumstances to report their income on other than an actual receipt or disbursement basis, no matter how they have kept their books.

The Treasury Department's rulings and regulations, hereinabove quoted, remained unchanged down to and after July 12, 1917, the date when the petitioner's amended income tax return for the year 1916 was executed.

On account of the petitioner's bookkeeping department being behind in its work, the petitioner was obliged, in the first instance, to file a tentative, inaccurate return of income for the year 1916, and as soon as correct figures were available, to wit, in July, 1917, the petitioner filed an amended income tax return for 1916, which was made up by the petitioner's secretary and auditor in conjunction with a government auditor who was then at the petitioner's plant auditing the figures for the petitioner's income

tax return and munitions manufacturers' tax return for the year 1916. (See Record, pp. 33, 34 and 39.)

The petitioner's amended income tax return for the year 1916 was made out as follows: The gross income from operations was figured in the method required by the form of Item 3(a) on the reverse side of the income tax return blank furnished by the Treasury Department, and the petitioner's ordinary bills and accounts receivable and payable, arising from its manufacturing operations, were treated as cash receipts and disbursements on the dates when they were entered on the books, and the other items, including rentals and interest and taxes, were actual cash receipts and disbursements during the year. (See Record, pp. 33, 34, 36, 37, 38, 39, 40, 41, 69 and 73.) The petitioner's secretary was familiar with the Treasury Department's regulations and rulings governing actual receipt and disbursement returns (See Record, pp. 34, 35 and 39); and a comparison of the petitioner's income tax return with the Treasury Department's regulations and rulings hereinabove cited will disclose that the petitioner's amended income tax return was made out in exact compliance with the Treasury Department's regulations and rulings then governing actual receipt and disbursement returns (See Record, p. 39).

The petitioner's amended income tax return for the year 1916, thus made out and filed by the petitioner in collaboration with the Internal Revenue Department's auditor, figured the income very differently from the income shown on the petitioner's books of account (See *infra*, p. 18, as to the books of account) in that, subject to the questions, hereinafter discussed, as to the method of figuring gross income from operations by the use of inventories and the treatment of ordinary bills and accounts receivable and payable, arising from the petitioner's manufacturing operations, as cash receipts and disbursements, the accru-

als and reserves on the petitioner's books of account were omitted in figuring the petitioner's income tax return (See Record, pp. 34, 36, 37 and 38). For example, the taxes actually paid by the petitioner during the year 1916 and the taxes reported on the petitioner's income tax return for the year 1916 amounted to $26,493.44 (See Record, pp. 34 and 83); whereas the taxes accrued, or for which reserves were set up, on the petitioner's books, during the year 1916, amounted to $130,924.19 (See Record, pp. 38, 52 and 125).

The petitioner made out its amended income tax return for the year 1916 in exactly the same way as it had done the previous year (See Record, p. 36), and did not elect to avail itself of the privilege granted by Section 13(d) of the Act of September 8, 1916, to make its return upon the basis upon which its accounts were kept, unless, as contended by the respondent, the filing of said return, in itself, conclusively constituted such election, the petitioner's intention to the contrary notwithstanding (See Record, p. 34). Moreover, in answer to the question on the income tax return blank for the year 1916, "State whether or not this return is made on the basis of actual receipts and disbursements," the petitioner answered, "Yes." (See Record, p. 80). The petitioner's amended income tax return for the year 1916 was audited and approved, as filed, by the Treasury Department, and this audit and approval has never since been modified or questioned by the Treasury Department except as to the one item of the munitions manufacturers' tax deduction (See Record, pp. 34 and 39).

During the years 1916 and 1917 and previous thereto, the entries in the petitioner's books of account were made as follows: The entries in some accounts were made on the so-called "accrual basis"; the entries in some accounts were made when the invoices of the items were made out

or received by the petitioner; and the entries in some accounts were made on the basis of actual cash receipts and disbursements. That the foregoing statement is true is amply shown by the petitioner's testimony (See Record, pp. 34, 36, 41 and 42) and expressly admitted by one of the respondent's accountants who testified in this case (See Record, p. 47).

The munitions manufacturers' taxes of the petitioner were never accrued on its books, nor were any reserves ever set up against its munitions manufacturers' taxes (See Record, p. 31),—the petitioner's munitions manufacturers' taxes being one of the accounts set up on the petitioner's books on an actual receipt and disbursement basis. The first and only entry with reference to the munitions manufacturers' tax, which appears on the petitioner's books, was in July, 1917, when the payment of the tax was entered on the petitioner's books on the date when it was actually paid (See Record, pp. 34 and 41).

On October 3, 1917, paragraphs third and fourth of Subdivision (a) of Section 12 of the Act of September 8, 1916, were amended so as to read as follows, the italics indicating the words and clauses added by amendment (40 Stat. 335):

> "Third. The amount of interest paid within the year on its indebtedness (*except on indebtedness incurred for the purchase of obligations or securities the interest upon which is exempt from taxation as income under this title*) to an amount of such indebtedness not in excess of the sum of (a) the entire amount of the paid-up capital stock outstanding at the close of the year, or, if no capital stock, the entire amount of capital employed in the business at the close of the year, and (b) one-half of its interest-bearing indebtedness then outstanding:
>
> * * * *

"Fourth. Taxes paid within the year imposed by the authority of the United States (*except income and excess profits taxes*), or *of* its Territories, or possessions, or any foreign country, or *by* (under) the authority of any State, county, school district, or municipality, or other taxing subdivision of any State, not including those assessed against local benefits."

It will be noted that the only substantial change in the clause covering the deduction of taxes is that income and excess profits taxes are excepted from the taxes which may be deducted from gross income in figuring taxable income.

On December 17, 1917, the Commissioner of Internal Revenue issued the following ruling (See Record, pp. 141-142):

"These provisions of law (Sec. 13(d) of the Act of September 8, 1916) authorize corporations and joint stock companies, or associations, and insurance companies, keeping books of account on an accrued basis, to deduct from gross income in returns of annual net income the accrual of interest for the return year within the limits prescribed by the taxing acts when shown as a charge against accrued income upon the books of account."

Here again it will be noted that the change from an actual receipt and disbursement basis to an accrual basis, in making income tax returns, is purely permissive and not obligatory.

There were no other pertinent income tax rulings made prior to March, 1918, when the income tax returns for the year 1917 had to be filed, Article 191 of Regulations 33, as it stood in March, 1918, reading as follows (See Record, p. 142):

"*Taxes deductible.*—Taxes imposed against a corporation by authority of the United States (except income and excess-profits taxes) its territories or any

foreign country, or by authority of any State, county, school district, municipality, or other taxing sub-division of a State (not including those assessed against local benefits) and paid within the year for which the return is made, are deductible from the gross income of a domestic corporation."

The petitioner made out its income tax return for the year 1917 in exactly the same way that it had made out its income tax returns for the years 1915 and 1916, in strict compliance with the then regulations of the Treasury Department, governing actual receipt and disbursement returns, and the requirements of the income tax return blank (See particularly item 4(a), Record, p. 93) which the Treasury Department required to be used, and did not elect to avail itself of the privilege granted by Section 13(d) of the Act of September 8, 1916, to make its return upon the basis upon which its accounts were kept, unless, as contended by the respondent, the filing of said return, in itself, conclusively constituted such election, the petitioner's intention to the contrary notwithstanding (See Record, pp. 33, 34, 36, 38, 39 and 40). Moreover, in answer to the question on the 1917 income tax return blank, "Is this return made on the basis of actual receipts and disbursements?" the petitioner answered, "Yes, except as below indicated," and below it is stated that "Bills and accounts payable and receivable are treated as receipts and disbursements." (See Record, p. 98.)

IV.

SPECIFICATION OF ERRORS.

The petitioner duly excepted to the findings of fact and conclusions of law made by the District Court and to the judgment rendered by the District Court and to the failure of the District Court to make various findings of fact requested by the petitioner; but, as hereinabove set forth in

the Statement of the Case, there is no dispute about the facts in this case and the ultimate question raised by the various exceptions taken by the petitioner is whether or not, on the established facts, the petitioner is entitled to judgment in this case, and the argument in this Brief will be addressed directly to this question.

V.

SUMMARY OF ARGUMENT.

UNDER THE UNITED STATES INTERNAL REVENUE LAW OF 1913, INCOME TAX RETURNS HAD TO BE MADE ON THE ACTUAL RECEIPT AND DISBURSEMENT BASIS, BUT THE REGULATIONS ISSUED BY THE COMMISSIONER OF INTERNAL REVENUE REQUIRED MANUFACTURING COMPANIES TO FIGURE GROSS INCOME BY THE USE OF INVENTORIES AND THE COMMISSIONER OF INTERNAL REVENUE RULED THAT ACCOUNTS AND BILLS RECEIVABLE OF A CORPORATION WERE TO BE TREATED AS INCOME FOR THE YEAR IN WHICH THE ACCOUNTS WERE SET UP ON THE BOOKS OR THE BILLS RECEIVABLE WERE ACCEPTED AND THAT ACCOUNTS PAYABLE, REPRESENTING THE ORDINARY AND NECESSARY EXPENSES OF MAINTAINING AND OPERATING THE CORPORATION'S BUSINESS AND PROPERTY, MIGHT BE DEDUCTED FROM THE GROSS INCOME OF THE YEAR IN WHICH THE EXPENSES WERE INCURRED. RETURNS THUS MADE WERE REGARDED AND ACCEPTED BY THE COMMISSIONER OF INTERNAL REVENUE AS MADE ON THE BASIS OF ACTUAL RECEIPTS AND DISBURSEMENTS. THE UNITED STATES INTERNAL REVENUE LAW OF 1916 WAS SUBSTANTIALLY THE SAME, SO FAR AS PERTINENT TO THE CASE AT ISSUE, AS THE REVENUE LAW OF 1913, EXCEPT FOR THE OPTION GIVEN THE TAXPAYER AS HEREINAFTER SET FORTH; AND THE REGULATIONS ISSUED BY THE COMMISSIONER OF INTERNAL REVENUE UNDER THE REVENUE LAW OF 1913 WERE BY THE COMMISSIONER EXPRESSLY MADE APPLICABLE TO THE REVENUE LAW OF 1916. WHILE THE REVENUE LAW OF 1916 ALLOWED THE TAXPAYER TO MAKE ITS INCOME TAX RETURNS ON THE SAME ACTUAL RECEIPT AND DISBURSEMENT BASIS AS THE REVENUE LAW OF 1913, THE REVENUE LAW OF 1916 GAVE AN OPTION TO A CORPORATION KEEPING ACCOUNTS ON ANY BASIS OTHER THAN THAT OF

ACTUAL RECEIPTS AND DISBURSEMENTS TO MAKE ITS INCOME TAX RETURNS UPON THE BASIS UPON WHICH ITS ACCOUNTS WERE KEPT. IN THE CASE AT ISSUE, THE PETITIONER NEVER EXERCISED THIS OPTION, BUT, ON THE CONTRARY, MADE OUT ITS INCOME TAX RETURNS FOR THE YEARS 1916 AND 1917 IN EXACT CONFORMITY WITH THE THEN REGULATIONS AND RULINGS OF THE COMMISSIONER OF INTERNAL REVENUE GOVERNING ACTUAL RECEIPT AND DISBURSEMENT RETURNS, AND EXACTLY LIKE THE PETITIONER'S RETURNS UNDER THE REVENUE LAW OF 1913,—THE PETITIONER'S INCOME TAX RETURNS FOR THE YEARS 1916 AND 1917 REPORTING ACTUAL CASH RECEIPTS AND DISBURSEMENTS, SUBJECT TO THE USE OF INVENTORIES AND THE TREATMENT OF ACCOUNTS AND BILLS RECEIVABLE AND PAYABLE, AS ABOVE SET FORTH, A USE AND TREATMENT WHICH WERE THEN NOT ONLY PERMITTED BUT REQUIRED BY THE COMMISSIONER OF INTERNAL REVENUE IN ACTUAL RECEIPT AND DISBURSEMENT RETURNS. MOREOVER, THE PETITIONER'S INCOME TAX RETURNS FOR THE YEARS 1916 AND 1917 FIGURED THE INCOME VERY DIFFERENTLY FROM THE INCOME SHOWN ON THE PETITIONER'S BOOKS OF ACCOUNT, IN THAT THE ACCRUALS AND RESERVES SET UP ON THE PETITIONER'S BOOKS WERE ELIMINATED IN MAKING OUT THE TAX RETURNS AND THE TAX RETURNS WERE MADE SHOWING ACTUAL CASH RECEIPTS AND DISBURSEMENTS, SUBJECT TO THE USE OF INVENTORIES AND THE TREATMENT OF BILLS AND ACCOUNTS RECEIVABLE AND PAYABLE AS HEREINABOVE SET FORTH. MOREOVER, THE PETITIONER, IN ITS INCOME TAX RETURN FOR THE YEAR 1916, EXPLICITLY STATED THAT THE RETURN WAS MADE ON THE BASIS OF ACTUAL RECEIPTS AND DISBURSEMENTS, AND IN ITS INCOME TAX RETURN FOR THE YEAR 1917, EXPLICITLY STATED THAT THE RETURN WAS MADE ON THE BASIS OF ACTUAL RECEIPTS AND DISBURSEMENTS EXCEPT THAT BILLS AND ACCOUNTS PAYABLE AND RECEIVABLE WERE TREATED AS RECEIPTS AND DISBURSEMENTS. UNDER THE FOREGOING CIRCUMSTANCES, THE EVIDENCE IS CONCLUSIVE THAT THE PETITIONER MADE OUT ITS INCOME TAX RETURNS FOR THE YEARS 1916 AND 1917 ON THE ACTUAL RECEIPT AND DISBURSEMENT BASIS AS THEN PRESCRIBED BY THE COMMISSIONER OF INTERNAL REVENUE, AND DID NOT ELECT TO MAKE ITS INCOME TAX RETURNS ON THE BASIS ON WHICH ITS ACCOUNTS WERE KEPT OR ON THE SO-CALLED "ACCRUAL BASIS."

EVEN IF WE ASSUME THAT IT WAS IMPROPER FOR THE PETITIONER IN AN ACTUAL RECEIPT AND DISBURSEMENT RETURN TO USE INVENTORIES IN FIGURING ITS GROSS INCOME FROM OPERATIONS AND TO TREAT ACCOUNTS RECEIVABLE AND PAYABLE, ARISING OUT OF ITS MANUFACTURING OPERATIONS, AS CASH RECEIPTS AND DISBURSEMENTS ON THE DATES WHEN THEY WERE ENTERED ON THE BOOKS, YET THE PETITIONER'S INCOME TAX RETURNS FOR THE YEARS 1916 AND 1917, HAVING BEEN AVOWEDLY MADE ON THE ACTUAL RECEIPT AND DISBURSEMENT BASIS AND HAVING BEEN MADE IN EXACT CONFORMITY WITH THE THEN REGULATIONS AND RULINGS OF THE COMMISSIONER OF INTERNAL REVENUE GOVERNING ACTUAL RECEIPT AND DISBURSEMENT RETURNS, THE ONLY CORRECTION, IF ANY, THAT THE COMMISSIONER OF INTERNAL REVENUE COULD PROPERLY HAVE MADE, IF HE HAD AFTERWARD CHANGED THE TREASURY DEPARTMENT REGULATIONS AND RULINGS, WAS TO CORRECT THE INCOME TAX RETURNS ON THE BASIS ON WHICH THEY WERE INTENDED TO BE MADE, TO WIT, THE ACTUAL RECEIPT AND DISBURSEMENT BASIS.

EVEN IF WE ASSUME THAT THE PETITIONER HAD ELECTED TO MAKE ITS INCOME TAX RETURNS FOR THE YEARS 1916 AND 1917 ON THE SAME BASIS ON WHICH ITS ACCOUNTS WERE KEPT, THE MUNITIONS MANUFACTURERS' TAX WOULD NOT HAVE BEEN DEDUCTED IN THE YEAR 1916 BUT IN THE YEAR 1917; FOR THE PETITIONER'S ACCOUNTS WERE KEPT ON SUCH BASIS THAT THE PETITIONER'S MUNITIONS MANUFACTURERS' TAX ACCOUNT WAS ENTERED ON ITS BOOKS ONLY ON AN ACTUAL DISBURSEMENT BASIS AND NOT ON AN ACCRUAL BASIS.

VI.

ARGUMENT.

The decision in the case at issue depends on the proper construction to be given to the decisions and opinion of this Court in the cases of *United States vs. Anderson* and *United States vs. Yale and Towne Manufacturing Company*, 269 U. S. 422. In these cases, it was held as stated in the syllabus:

> "1. The Revenue Act of 1916 imposed a tax on net income and profits ascertained by deducting from

gross income, expenses paid, losses sustained, interest and taxes paid during the calendar year, but provided, § 13(d), that 'a corporation * * * keeping accounts upon any basis other than that of actual receipts and disbursements, unless such other basis does not clearly reflect its income, may, subject to regulations of the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, make its return upon the basis upon which its accounts are kept, in which case the tax shall be computed upon its income as returned.'

"*Held,* that where the taxpayer's books, reflecting its income, were kept upon an 'accrual' basis, i.e., by charging against income earned during the taxable period (1916) the expenses incurred in and attributable to the process of earning income during that period, and made its return upon that basis and not the basis of actual receipts and disbursements, it was permitted under the statute, as correctly construed by a Treasury regulation, to include in its deductions the amount of a 'reserve' entered on its books for taxes imposed by the United States on the profits of munitions made and sold by the taxpayer during that year, although the tax had not 'accrued' in the sense of having been assessed and become due; and that it was not permissible, as the taxpayer attempted, to defer deduction of the tax until the income return for the following year, during which the tax became due and was paid. Pp. 438, 441."

The courts below construed the opinion of this Court in the *Anderson* and *Yale and Towne Manufacturing Company* cases as holding that the combined effect of Sections 12(a) and 13(d) of the Internal Revenue Act of 1916 was that if the taxpayer "failed or was unable" to make its income tax return on a *strict* receipts and disbursements basis, the taxpayer was *required* to make its return on the "accrual basis"; that inventories and bills and accounts payable and receivable are not properly used in a *strict* re-

ceipts and disbursements return, and that, therefore, where the taxpayer used inventories and treated certain bills and accounts receivable and payable as cash receipts and disbursements in its income tax returns, it had failed to make a return on a *strict* receipts and disbursements basis and consequently its return must be made on an "accrual basis." This construction is based on the following italicized *obiter dicta* in this Court's opinion:

> "Standing by themselves and taken at their face value, these sections (Sections 12(a) and 13(d) of the Internal Revenue Act of 1916) would seem to require the taxpayer to make his return on the basis of receipts and disbursements or, in the alternative, on the basis of its own books of account if they reflect true income, under such regulations as the Commissioner may make, *and indeed to require the latter alternative if the taxpayer is unable to make his return on that basis.*" (269 U. S. 437)

and

> "It was to enable taxpayers to keep their books and make their returns according to scientific accounting principles, by charging against income earned during the taxable period, the expenses incurred in and properly attributable to the process of earning income during that period; *and indeed, to require the tax return to be made on that basis, if the taxpayer failed or was unable to make the return on a strict receipts and disbursements basis.*" (269 U. S. 440)

We respectfully challenge the accuracy and the soundness of the foregoing *obiter dicta*, and submit that the italicized statements could not possibly be correct statements of the law.

Section 12(a) of the Internal Revenue Act of 1916, like Section G(b) of the Internal Revenue Law of 1913, provided for an actual receipt and disbursement return. Section 13(d) of the Internal Revenue Act of 1916 merely

gave to the taxpayer an option to make its income tax return on the basis on which its accounts were kept. This option the taxpayer might or might not exercise, as it deemed for its own best interests. *There is absolutely nothing in the law which can possibly be construed as obliging the taxpayer to exercise the option under any circumstances.* The question, therefore, is: Did the taxpayer elect to make its income tax returns on the basis on which its accounts were kept? If so, then, as held by this Court in the *Anderson* and *Yale and Towne Manufacturing Company* cases, the taxpayer must consistently follow its books of account; otherwise, the taxpayer must make an actual receipt and disbursement return under Section 12(a). There is nothing in the law which can possibly be construed as providing that in case the taxpayer "fails or is unable" properly to make out an actual receipt and disbursement return, then the Commissioner of Internal Revenue may compel the taxpayer to make out a return on the basis of the taxpayer's accounts. The law did not recognize any inability on the part of the taxpayer to make an actual receipt and disbursement return. As a matter of fact, it is certainly possible for any taxpayer keeping books of account on any basis to make an absolutely strict receipt and disbursement tax return. All one has to do is to use the entries of cash receipts and disbursements on the books. The actual receipts and disbursements basis may distort income to some extent as between different years but if this be objectionable, the defect was in the laws permitting actual receipts and disbursements returns, —a defect which it is not the province of the courts to rectify. It may be added that in the Act of 1918, the Commissioner of Internal Revenue was given power to redetermine the taxpayer's income on such basis as he might prescribe (See excerpt from *American Can Co. vs. United States,* cited *infra,* p. 38), thus remedying the defect, if it be considered such. The petitioner therefore respect-

fully submits that it is a logical impossibility to say that the added option given the taxpayer in Section 13(d) of the Internal Revenue Act of 1916 could under any circumstances require the taxpayer to make its income tax returns on the basis of its accounts or on an accrual basis, if the taxpayer did not elect to do so.

As indicated by the foregoing discussion, the petitioner contends that the effects of Sections 12(a) and 13(d) of the Internal Revenue Act of 1916, upon the fair construction of this Court's opinion, as a whole, in the *Anderson* and *Yale and Towne Manufacturing Company* cases, are as follows:

Section 12 (a) of the Internal Revenue Law of 1916 provided for an actual receipts and disbursements income tax return of exactly the same type and character as required by the Internal Revenue Law of 1913. Section 13(d) of the Internal Revenue Law of 1916 merely gave to the taxpayer an added option, which the taxpayer might or might not exercise, as it chose, to make its income tax return on the basis on which its accounts were kept. The question, therefore, is: Did the taxpayer make its return on an actual receipt and disbursement basis as that basis was then defined and required by the Treasury Department of the United States, or did the taxpayer elect to make its income tax return on the basis on which its accounts were kept? If the taxpayer elects to make its income tax return on the basis on which its accounts are kept, then the taxpayer must follow its accounts in making its income tax return; otherwise the taxpayer must make an actual receipt and disbursement return as then defined by the Treasury Department.

Cf. argument of Solicitor General Mitchell, found in 269 U. S. 423 and reading as follows:

> "Under the Revenue Act of 1916 a taxpayer was permitted to make his income-tax return on an accrual

basis if his books were kept on that basis. Corporation Excise Tax Law of 1909 plainly required the computation of net income on the basis of actual receipts and disbursements. There was no provision for accrual systems of accounting or for including items of expense incurred but not due and paid. The first corporation income tax Act of October 3, 1913, like the 1909 Act, provided for the calculation of net taxable income on the receipts and disbursements basis. Under these two Acts some departures from the strict receipts and disbursements basis were permitted by the Commissioner of Internal Revenue, such as the use of inventories. This legislation shows that the subject was undeveloped and the resulting system was a mongrel one, but, in the main, the returns were required to be made on a receipts and disbursements basis. *Lumber Mutual Fire Ins. Co. v. Malley,* 256 Fed. 380; *Maryland Casualty Co. v. United States,* 52 Ct. Cls. 201; same case, 251 U. S. 342. The first decided shift occurred in the Revenue Act of 1916, evidenced by the insertion of a new provision, § 13(d). This allowed the taxpayer the option to make his return on a cash basis without regard to how he kept his books, or if he kept his books on some other basis to make his return upon the basis upon which his accounts were kept."

In the case at issue, the petitioner made out its income tax returns for the years 1916 and 1917 on the basis of actual receipts and disbursements as then defined by the regulations and rulings of the Commissioner of Internal Revenue and in exact conformity with the Commissioner's regulations and rulings then governing actual receipt and disbursement returns, and the petitioner did not elect, under Section 13(d) of the Revenue Act of 1916, to make its income tax returns on the basis on which its accounts were kept on its books.

As hereinabove shown in the Statement of the Case, the petitioner indisputably made out its income tax re-

turns for the years 1916 and 1917 on the basis of actual receipts and disbursements, unless, as claimed by the respondent, the fact that the petitioner (to use the language of the respondent's witness) "used inventories in ascertaining their cost of goods, as well as the fact that they took the accounts receivable and the accounts payable in consideration as cash items," conclusively proves that the petitioner's income tax returns for the years 1916 and 1917 were made out on the so-called "accrual basis,"—it being the contention of the respondent that the method of arriving at gross income from operations by the use of inventories, in the manner set forth in Item 3(a) of the 1916 income tax return blank, and in Item 4(a) of the 1917 income tax return blank, plus the fact that bills and accounts receivable and payable arising in the course of the petitioner's manufacturing operations were treated as cash items on the dates when they were set up on the petitioner's books of account, render the petitioner's income tax returns for 1916 and 1917 so-called "accrual" returns and constituted an election on the part of the petitioner to avail itself of the privilege granted by Section 13(d) of the Revenue Act of 1916.

A review, however, of the regulations and rulings issued by the Commissioner of Internal Revenue prior to and during the years 1916 and 1917 and governing income tax returns for those years, shows clearly that the foregoing contention of the respondent is unsound. The Internal Revenue Law of 1913 *required* the taxpayer to make out income tax returns on the basis of actual receipts and disbursements (See Law Opinion 1059 and argument of the Solicitor General, 269 U. S. 423, hereinabove quoted), and thereunder, as hereinabove set forth in detail in the Statement of the Case, while the regulations issued by the Commissioner of Internal Revenue provided that taxes, interest and other items must be reported for the years when

the cash was spent out or taken in, yet these regulations *required* that the gross income of manufacturing companies, as reported in the income tax returns, should consist of the total sales of manufactured goods during the year covered by the return, increased or decreased by the gain or loss as shown by the inventories of finished and unfinished products, raw material, etc., at the beginning and end of the year, and the Commissioner of Internal Revenue ruled that accounts and bills receivable of a corporation *must* be treated as income for the year in which they were created, that is to say, in the year in which the accounts were set up on the books or the bills receivable were accepted, and that accounts payable, representing the ordinary and necessary expenses of maintaining and operating the corporation's business and property, might be deducted from the gross income of the year in which the expenses were incurred. The foregoing regulations and rulings under the Revenue Act of 1913, as hereinabove shown in the Statement of the Case, were by the Commissioner of Internal Revenue expressly extended to and continued in effect under the Revenue Act of 1916, which did not change or alter in any respect the right of the taxpayer to make its income tax returns upon the same actual receipt and disbursement basis which was required under the 1913 Act, but merely gave to a corporate taxpayer keeping accounts upon any basis other than that of actual receipts and disbursements an option, which it might or might not exercise, as the taxpayer deemed best, to make its income tax returns upon the basis upon which its accounts were kept.

The petitioner's income tax returns for the years 1916 and 1917 were made out by the petitioner's Secretary, who, at the time when he made out the returns, was familiar with the foregoing regulations and rulings, and these returns were made out by the petitioner's Secretary as actual receipt and disbursement returns, in exact conformity with

the rulings and regulations of the Commissioner of Internal Revenue then governing such actual receipt and disbursement returns, and in exact compliance with the requirements of the form of income tax blanks furnished by the Internal Revenue Department and required to be used in making the income tax returns, and it was specifically stated on the income tax returns for the years 1916 and 1917 that the return was made on the basis of actual receipts and disbursements, it being added on the 1917 return that bills and accounts payable and receivable are treated as receipts and disbursements.

As above stated, there is no question but that the petitioner's income tax returns for the years 1916 and 1917 were actual receipt and disbursement returns, unless the two features testified to by the government's accountants, to wit, the use of inventories and the treatment of bills and accounts receivable and payable arising out of the petitioner's manufacturing operations, as cash receipts and disbursements, changed the returns into accrual returns. There can be no question but that the rulings and regulations of the Commissioner of Internal Revenue then in force were to the effect that these returns, as made out by the petitioner, were proper actual receipt and disbursement returns. There is no question but that the two features of the returns which are now claimed by the respondent to prevent the petitioner's returns from being actual receipt and disbursement returns, were features not only that the petitioner was then permitted to use in actual receipt and disbursement returns, but that the petitioner *was then required* to use in actual receipt and disbursement returns, both by the regulations issued by the Commissioner of Internal Revenue, then in effect, and by the form of the income tax blanks required by the Internal Revenue Department to be used by the petitioner. Indeed, a moment's reflection will show that when the

Commissioner of Internal Revenue compelled the figuring of gross income from operations by adding sales and closing inventory and subtracting purchases and opening inventory, the Commissioner of Internal Revenue not only compelled the use of inventories, but also compelled the treatment of bills and accounts receivable, growing out of the sales, as cash receipts, and of bills and accounts payable, growing out of purchases of materials, as cash disbursements. The petitioner's income tax returns for 1916 and 1917 were consequently proper actual receipt and disbursement returns *correctly* made out under the regulations and rulings of the Commissioner of Internal Revenue then in force, and thereunder, in such actual receipt and disbursement returns, taxes could be deducted only when paid.

The lower courts held that the foregoing argument had been rejected by this Court in the *Anderson* case (See Record, pp. 14-15 and 168-169).

In so holding, we submit that the lower courts have clearly fallen into error. The argument made in the *Anderson* case (See 269 U. S. 422, 438-439) was that inasmuch as the Treasury Regulations under the 1909 and 1913 Acts permitted the use of inventories and authorized the deduction of certain expenses although not paid, in ascertaining net income, but did not permit the deduction of taxes except in the year when paid, Congress by reenacting in §12(a) of the Act of 1916 the corresponding provisions of the earlier Acts, adopted the settled administrative practice, and that, accordingly, under that Act as well as under the earlier Acts, taxes could be deducted *only in the year when paid;* but this Court said that Section 13(d) of the Act of 1916 gave to the taxpayer an option, not given in the earlier Acts, to report income on a different basis than that of actual receipts and disbursements, provided the taxpayer's books were kept on such

different basis, and that, accordingly, a taxpayer keeping its books *and* reporting its income on an accrual basis must deduct taxes when accrued.

The argument advanced in the *Anderson* case is an entirely different argument than the proposition maintained by the petitioner in the case at issue. The petitioner in the case at issue does not maintain that it had no option to report taxes on the accrual basis if the tax accounts were kept in its books on that basis, but does maintain that the income tax returns filed by the petitioner for the years 1916 and 1917 were of the type and character that were then not only regarded but required by the Commissioner of Internal Revenue, as and for actual receipt and disbursement returns under the 1913 Act and the regulations issued thereunder, and under the 1916 Act and the Internal Revenue Commissioner's ruling of September 14, 1916, making the regulations under the 1913 Act applicable to the 1916 Act, and that it is impossible justly or logically to say that the petitioner, having made an income tax return of the type and character then prescribed and defined by the Commissioner of Internal Revenue for and as actual receipt and disbursement returns, can, by having filed such return, be deemed to have elected to make, or to have made, a so-called "accrual" return.

It may be noted that the Circuit Court of Appeals, in its opinion, mentioned the item of depreciation as indicating an accrual return under Section 13(d) of the Internal Revenue Law of 1916, but this is clearly unsound for Section 12(a) of the Internal Revenue Law of 1916 specifically provided for depreciation.

Even if there be a question as to the correctness of the use of inventories and the treatment of bills and accounts receivable and payable as actual receipts and disbursements, in actual receipt and disbursement returns,

the evidence is conclusive that the petitioner never elected to change its income tax returns from the actual receipt and disbursement basis, required by the Law of 1913, to the basis on which its accounts were kept on its books, which was permitted by Section 13(d) of the Revenue Law of 1916. Besides the direct testimony of the petitioner's Secretary on this point (See Record, p. 34), the following facts are incontrovertible and decisive: The petitioner never took any action under favor of said Section 13(d). It continued to keep its books of account after the passage of the Act of September 8, 1916, in exactly the same method that it had kept its books of account prior to the passage of the Act, and it continued to make its income tax returns to the Internal Revenue Department after the passage of the Act of September 8, 1916, in exactly the same manner in which it had made its returns prior to the passage of the Act. Furthermore, the petitioner neither before nor after the passage of the Act of September 8, 1916, made its income tax returns on the basis on which its accounts were kept. In the petitioner's books the entries in some accounts were cash receipt and disbursement entries; the entries in some accounts were made on the dates when the invoices of the items were made out or received by the petitioner; and the entries in some accounts were accruals and reserves. The petitioner's income tax returns figured the petitioner's income very differently from the income shown on the petitioner's books of account, in that the accruals and reserves set up on the petitioner's books of account were eliminated in making out the petitioner's income tax returns and the tax returns were made showing actual cash receipts and disbursements, subject to the use of inventories and the treatment of ordinary bills and accounts receivable and payable as hereinabove set forth. An example of the fact that the difference between the petitioner's books and the petitioner's income tax returns

is not inconsiderable is found in the item of taxes for the year 1916. The taxes actually paid by the petitioner during the year 1916, and the taxes reported on the petitioner's income tax return for the year 1916 amounted to $26,493.44, whereas the taxes accrued or for which reserves were set up on the petitioner's books during the year 1916, amounted to $130,924.19. Moreover, the petitioner expressly declared in its income tax returns for 1916 and 1917 that the returns were made on a cash receipt and disbursement basis, adding in the 1917 return that bills and accounts receivable and payable are treated as receipts and disbursements.

Even if we assume that it was improper for a corporation, in an actual receipt and disbursement basis return, to use inventories in figuring its gross income from operations, and to treat its accounts receivable and payable, arising out of its manufacturing operations, as cash receipts and disbursements on the dates when they were entered on the books; even if we assume that the petitioner should have disobeyed the regulations and rulings promulgated by the Commissioner of Internal Revenue and disregarded the corporation income tax return blanks supplied by the Commissioner of Internal Revenue and by him required to be used by all corporations, and should have figured its gross income from operations without using inventories, and without considering sales of products or purchases of raw materials and the consequent bills and accounts receivable and payable; even on these assumptions, the only thing that the Commissioner of Internal Revenue had a right to do to correct the defect, was to correct the returns on an actual receipt and disbursement basis. The petitioner's income tax returns for 1916 and 1917 were avowedly made on an actual receipt and disbursement basis and it was so stated in the returns, and they were made in accordance with the then rules and regulations governing actual re-

ceipt and disbursement returns; and even if it be assumed that the items complained of by the respondent were not correctly reported in an actual receipt and disbursement return, the Commissioner of Internal Revenue had no right to shift the returns to an entirely new basis, but could properly correct the returns only on an actual receipt and disbursement basis,—the basis on which they were intended to be made.

Even if the petitioner had elected to make its income tax returns for the years 1916 and 1917 on the same basis as the basis on which its accounts were kept, the munitions manufacturers' tax would not have been deducted in the year 1916, but in the year 1917; for the petitioner's books of account were kept on a mixed basis, some accounts being accrued and some containing only actual receipt and disbursement items, and in the petitioner's books of account the petitioner's munitions manufacturers' tax was entered only on an actual disbursement basis. There was no entry with reference to the petitioner's munitions manufacturers' tax on its books during the year 1916. The first and only entry with reference to the petitioner's munitions manufacturers' tax was made in July, 1917, when the tax was paid. The petitioner's earnings statement for the year 1916, made out according to the accounts on its books, did not reflect the accrual or the payment of the munitions manufacturers' tax, and if the petitioner had made its income tax return for the year 1916 so that its income statement thereon jibed precisely with the income statement from its books, the munitions manufacturers' tax would not have been used as a deduction in 1916.

In the consideration of the foregoing point it should be remembered that Section 13(d) of the Revenue Act of 1916 makes no use of the words "accrue" or "accrual" but merely permits a corporation to make its income tax returns on the basis on which its accounts are kept (See 269

U. S. 422, 441), and that in both of the two cases decided by this Court the corporation's accounts were so kept that the munitions manufacturers' tax was accrued on the corporation's books, while in the case at issue the petitioner's accounts were so kept that the petitioner's munitions manufacturers' tax was not accrued on the petitioner's books.

If it be argued by the respondent that the fact that the petitioner contested the munitions manufacturers' tax, as applied to its products, may have been a reason why the tax was not accrued on the petitioner's books, a conclusive answer is that that fact would be a sufficient reason why the tax should not be accrued and why it should not be deducted in 1916.

If it be claimed that the mixed basis upon which the petitioner kept its books did not reflect true net income, then the Commissioner of Internal Revenue had but one alternative under the income tax law of 1916 and the rulings and regulations promulgated by the Treasury Department thereunder, and that was to correct the petitioner's income tax returns on an actual receipt and disbursement basis.

Treasury Decision 2433, Record, p. 141;
American Can Co. vs. United States, 31 Fed. Rep. (2nd) 730, (C. C. A., 3d Circ.).

In this case the Court said (p. 731):

"Since the basis used by the plaintiffs did not reflect their true income, to what basis could the Commissioner legally change? Section 13(d) of title I of the Revenue Act of 1916, 39 Stat. 771, provides that:

"'(d) A corporation, joint-stock company or association, or insurance company, keeping accounts upon any basis other than that of actual receipts and disbursements, unless such other basis does not clearly reflect its income, may, subject to regulations made by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, make its return upon the basis upon which its accounts are

kept, in which case the tax shall be computed upon its income as so returned.'

"Accordingly, if a corporation has kept its accounts upon a basis other than that of 'actual receipts and disbursements,' it may, subject to regulations of the Commissioner, with the approval of the Secretary of the Treasury, make its return upon that basis, and the tax on its income shall be computed as so returned, if it clearly reflects its income; but, if it does not clearly reflect its income, then the tax must be computed on the cash, or receipts and disbursements, basis as prescribed in section 12, which provides that:

"'Sec. 12. (a) In the case of a corporation, joint-stock company or association, or insurance company, organized in the United States, such net income shall be ascertained by deducting from the gross amount of its income received within the year from all sources—

First. All the ordinary and necessary expenses paid within the year in the maintenance and operation of its business and properties. * * *

Second. All losses actually sustained and charged off within the year. * * *

Third. The amount of interest paid within the year. * * *

Fourth. Taxes paid within the year. * * *'

"This is the receipts and disbursements, or cash, basis, and the tax must be assessed on this basis. (Citing authorities.)

"In the Act of 1918 (40 Stat. 1057, *et seq.*) Congress expressly conferred upon the Commissioner power to redetermine the income on such basis as he might prescribe; but he had no such power under prior acts, and, if the accrual or other basis used by the taxpayer in making his return did not reflect the true net income, he must use the cash basis.

> "As the basis which the Commissioner used in redetermining the tax was not authorized in the Act of 1916, it was contrary to law, as found by the District Court. The tax which the District Court ordered refunded was the excess which the plaintiffs paid, computed on the receipts and disbursements basis, and was right in law and fact."

It will be noted that the foregoing decision of the Circuit Court of Appeals for the Third Circuit is in conflict with the decision of the Circuit Court of Appeals for the Sixth Circuit in the case at issue. In the case in the Third Circuit, the Circuit Court of Appeals held that under the Internal Revenue Law of 1916 the Commissioner of Internal Revenue could correct the taxpayer's income tax return *only on a receipt and disbursement basis,* even though the return was intended to be, in general, an accrual return, while in the case at issue, the Circuit Court of Appeals held that under the Internal Revenue Law of 1916 the Commissioner of Internal Revenue could correct the taxpayer's income tax return on an accrual basis even though the return was intended to be and was, at least in the main, an actual receipt and disbursement return. Of course, the petitioner's contentions in the case at issue do not require a court to go nearly as far in obliging returns to be corrected only on an actual receipt and disbursement basis as does the decision of the Circuit Court of Appeals for the Third Circuit.

To say, as the respondent must, to succeed in the case at issue, that a corporation which has made its income tax return not only on a basis recognized under the then regulations and rulings of the Commissioner of Internal Revenue as an actual receipt and disbursement return, but in a form then required by the Commissioner of Internal Revenue for an actual receipt and disbursement return, and which, in its income tax return, has expressly declared the return to

be an actual receipt and disbursement return, and which has made out its return on a basis different from the basis on which its accounts are kept,—to say that such corporation has elected to make an income tax return on an accrual basis or on the basis on which its accounts are kept, is, we submit, not only unjust but logically unthinkable.

It may be added that the petitioner's amended income tax return for the year 1916 was made out by the petitioner's secretary and auditor in collaboration with an auditor from the Internal Revenue Department, who, at the same time, made out the petitioner's munitions manufacturers' tax return for the year 1916, and audited both returns; that the income tax return so made out, audited and approved by the Internal Revenue Department, was indisputably made out in every respect on an actual receipt and disbursement basis, subject to the disputed questions as to the use of inventories and the treatment of bills and accounts receivable and payable as cash receipts and disbursements, and that the return so made out, audited and approved by the Internal Revenue Department's representative was palpably and indisputably very erroneous if made on an accrual basis. It should further be noted that the Internal Revenue Department has still left the petitioner's 1916 income tax return made out on the same actual receipt and disbursement basis as that on which it was made out by the government auditor in conjunction with the petitioner's representatives, except as to the one item of the munitions manufacturers' tax. For example, the Internal Revenue Department has not allowed a deduction in the petitioner's 1916 income tax return of the sum of $108,006.55, Federal income tax accrued for the year 1916,* to-

*NOTE: 1916 income taxes deducted on an accrual basis would be deductible from 1916 income, but, since income taxes were made non-deductible in 1917, 1916 income taxes deducted on an actual disbursement basis would never be deductible.

gether with certain other accrued taxes, for the reason that the petitioner's 1916 income tax return *was* an actual receipt and disbursement return, and has deducted in the year 1916 a munitions tax alleged to have accrued in that year on the ground that the petitioner's 1916 income tax return *was not* an actual receipt and disbursement return but was a return made on the "accrual" basis. Certainly the courts should redress such indefensible injustice.

As hereinabove indicated, the decisions of the courts below in the case at issue have been due to their belief that the decision of this Court in the case of *United States vs. Anderson* compels a like decision in the case at issue, and, as hereinabove indicated, we respectfully submit that the lower courts are in error in such belief.

The decision in the *Anderson* case was expressly put upon the ground that the record in that case failed affirmatively to show either that the company's books were kept *or* that the company's tax returns were made on the basis of actual receipts and disbursements. (See 269 U. S. 422, 433.) In the case at issue all of the facts bearing on the questions on what basis the petitioner's accounts were kept and, more particularly, on what basis its income tax returns were made, are before this Court, and it is clearly shown that the accounts in the petitioner's books were on a mixed basis but that the petitioner's income tax returns were made on an actual receipt and disbursement basis in every particular, subject to the controverted questions as to the effect of the use of inventories and the treatment of ordinary bills and accounts receivable and payable as cash receipts and disbursements.

Moreover, some of the differences, at least, between the facts in the *Anderson* case and the facts in the case at issue are shown by the records. In the *Anderson* case, large reserves, accrued on the books of the company, were used as deductions from gross income in making out the tax return.

In the case at issue, such reserves, amounting to large sums of money, set up on the petitioner's books in the year 1916, were not used as deductions in making out the petitioner's tax returns. In the *Anderson* case, all income and expenditure items seem to have been reported on the accrual basis except the item of taxes. In the case at issue, the income tax returns were actual receipt and disbursement returns in every respect, subject to the disputed questions as to the effect of the use of inventories and the treatment of ordinary bills and accounts receivable and payable as cash receipts and disbursements. In the *Anderson* case, there was no declaration of the taxpayer as to the basis on which it made its income tax returns. In the case at issue, the petitioner expressly declared in its income tax returns that it made the returns on the basis of actual receipts and disbursements.

In the *Anderson* case the taxpayer set up reserves for and accrued its munitions manufacturers' tax on its books, while in the case at issue, the petitioner's munitions manufacturers' tax was never accrued on its books nor were any reserves ever set up against said tax.

VII.

IN CONCLUSION.

In conclusion, we may sum up as follows:

Under the provisions of the United States Internal Revenue Act of 1916 and under the proper construction of the decisions and opinion of this Court in the cases of *United States vs. Anderson* and *United States vs. Yale and Towne Manufacturing Company*, hereinabove cited, a corporation was obliged to make its income tax returns for the years 1916 and 1917 on an actual receipt and disbursement basis, as then defined by the Commissioner of Internal Revenue, unless the corporation kept its accounts

upon a basis other than that of actual receipts and disbursements, *and* unless the corporation elected to make its income tax returns upon the basis upon which its accounts were kept.

The petitioner's income tax returns for the years 1916 and 1917 were made on the basis of actual receipts and disbursements, as then defined by the regulations and rulings of the Commissioner of Internal Revenue, and in exact conformity with the Commissioner's regulations and rulings then governing actual receipt and disbursement returns; and thereunder the petitioner's taxes could be deducted only in the year when actually paid.

The petitioner never exercised its option to avail itself of the provisions of Section 13(d) of the Revenue Act of 1916, granting it the privilege of making its income tax returns on the basis on which its accounts were kept, as is conclusively proved, not only by the direct testimony of the petitioner's Secretary but by the following incontrovertible and decisive facts:

(a) The petitioner kept its books of account and made its income tax returns after the passage of the Revenue Act of 1916, containing Section 13(d), in exactly the same way as it had previously done under the Revenue Act of 1913, proving that no action under Section 13(d) of the 1916 Act was ever taken by the petitioner.

(b) The petitioner's books of account were kept on a mixed basis, there being both cash receipt and disbursement accounts and accrued and reserve accounts on the petitioner's books, whereas the petitioner's income tax returns for the years 1916 and 1917 figured the petitioner's income very differently from the income shown on the petitioner's books of account, in that the accruals and reserves, amounting

to large sums of money, set up on the petitioner's books of account, were eliminated in making out the petitioner's income tax returns, and the tax returns were made showing actual cash receipts and disbursements, subject to the use of inventories and the treatment of ordinary bills and accounts receivable and payable as cash receipts and disbursements.

(c) The petitioner expressly said in its income tax returns for the years 1916 and 1917 that these returns were made on the actual receipt and disbursement basis.

Even if we assume that it was improper for the petitioner in an actual receipt and disbursement return to use inventories in figuring its gross income from operations, and to treat bills and accounts receivable and payable, arising out of its manufacturing operations, as cash receipts and disbursements on the dates when they were entered on its books, and that the petitioner should have disobeyed the regulations and rulings of the Treasury Department, obliging such use of inventories and such treatment of bills and accounts receivable and payable, yet the income tax returns, having been avowedly made on the actual receipt and disbursement basis, and having been made in exact conformity with the then regulations and rulings of the Treasury Department governing actual receipt and disbursement returns, and in full compliance with the form of corporation income tax return which the Treasury Department supplied and required to be used by the petitioner, the only correction, if any, that the Commissioner of Internal Revenue could have properly made, if the Treasury Department had subsequently changed its regulations and rulings governing actual receipt and disbursement returns, was to correct the income tax returns on the basis on which they were intended to be made, to wit, the actual receipt and disbursement basis.

Even if we assume that the petitioner had elected to make its income tax returns for the years 1916 and 1917 on the same basis on which its accounts were kept, the munitions manufacturers' tax would not have been deducted in the year 1916 but in the year 1917, for the petitioner's accounts were kept on such basis that the petitioner's munitions manufacturers' tax account was entered on its books only on an actual disbursement basis and not on an accrual basis.

If it be claimed that the mixed basis upon which the petitioner kept its books did not reflect true net income, then the Commissioner of Internal Revenue had but one alternative under the income tax law of 1916 and the rulings and regulations promulgated by the Commissioner of Internal Revenue thereunder, and that was to correct the income tax returns on an actual receipt and disbursement basis.

The decision of this Court in the case of *United States vs. Anderson*, 269 U. S. 422, does not control the decision in the case at issue for at least three reasons.

In the first place, the record before this Court in the *Anderson* case did not affirmatively show that the taxpayer's income tax return was made on the basis of actual receipts and disbursements, but on the contrary apparently indicated that the return reported all items on the accrual basis except the item of taxes; whereas in the case at issue the petitioner's income tax returns for 1916 and 1917 were indisputably made on an actual receipt and disbursement basis in every particular, subject to the controverted questions as to the effect of the use of inventories and the treatment of ordinary bills and accounts receivable and payable as cash receipts and disbursements. For example, the record in the *Anderson* case showed that large reserves had been deducted in figuring income in the taxpayer's income tax return, while in the case at issue the record shows that

large reserves set up on the petitioner's books of account were not deducted in figuring the petitioner's income in its income tax returns.

In the second place, in the *Anderson* case there was no declaration of the taxpayer as to the basis on which it made its income tax returns, whereas in the case at issue the petitioner expressly declared in its income tax returns that it made the returns on the basis of actual receipts and disbursements.

In the third place, in the *Anderson* case a reserve for the munitions manufacturers' tax was set up on the taxpayer's books in the year 1916, and an income tax return for the year 1916, made on the basis on which the taxpayer's accounts were kept, would contain a deduction of a munitions manufacturers' tax accrual; whereas in the case at issue, the petitioner's munitions manufacturers' tax (as well as the items in some other accounts) was not accrued on the petitioner's books, nor were any reserves ever set up against said tax, so that an income tax return for the year 1916, made on the basis on which the petitioner's accounts were kept, would *not* contain any deduction of an accrued munitions manufacturers' tax.

The decision in the *Anderson* case, under the facts as found by this Court on the record in that case, is entirely in accord with the principles of law for which the petitioner herein contends, and the opinion of this Court in the *Anderson* case, with the exception of the two clauses of *obiter dicta* hereinabove discussed, lays down the principles of law for which the petitioner herein contends.

If the petitioner is correct in its contentions hereinabove set forth, the great injustice to the petitioner of the decisions of the lower courts in this case, is manifest; for the petitioner, having religiously complied with the rules and regulations of the Treasury Department of the United States, governing actual receipt and disbursement returns,

finds itself mulcted in the sum of $166,910.01, and interest thereon, besides the sum involved in the suit in the Court of Claims, due to the misinterpretation by the lower courts of the somewhat misleading opinion of this Court in the *Anderson* and *Yale and Towne Manufacturing Company* cases,—an injustice which can only be averted through the consideration and action of this Court.

WHEREFORE, it is respectfully submitted that this case is one calling for the exercise by this Court of its supervisory powers, in order that the important question of Federal law here involved may be correctly settled, and that the injustice done to the petitioner by the misinterpretation by the lower courts, in the case at issue, of this Court's opinion in the cases of *United States vs. Anderson* and *United States vs. Yale and Towne Manufacturing Company,* may be righted, and that to such end a writ of certiorari should be granted and this Court should review the decision of the Circuit Court of Appeals for the Sixth Circuit and finally reverse it and award the petitioner judgment in this cause for One Hundred and Sixty-Six Thousand Nine Hundred and Ten Dollars and One Cent ($166,910.01), together with interest thereon from July 14, 1923, at the rate of Six Per Cent (6%) per annum.

JOHN T. SCOTT,

Counsel for Petitioner.

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In the Supreme Court of the United States

OCTOBER TERM, 1929.

No. 7

THE ALUMINUM CASTINGS COMPANY,
Petitioner,

vs.

CARL F. ROUTZAHN, Individually and as
Collector of Internal Revenue,
Respondent.

BRIEF OF PETITIONER.

JOHN T. SCOTT,
Counsel for Petitioner.

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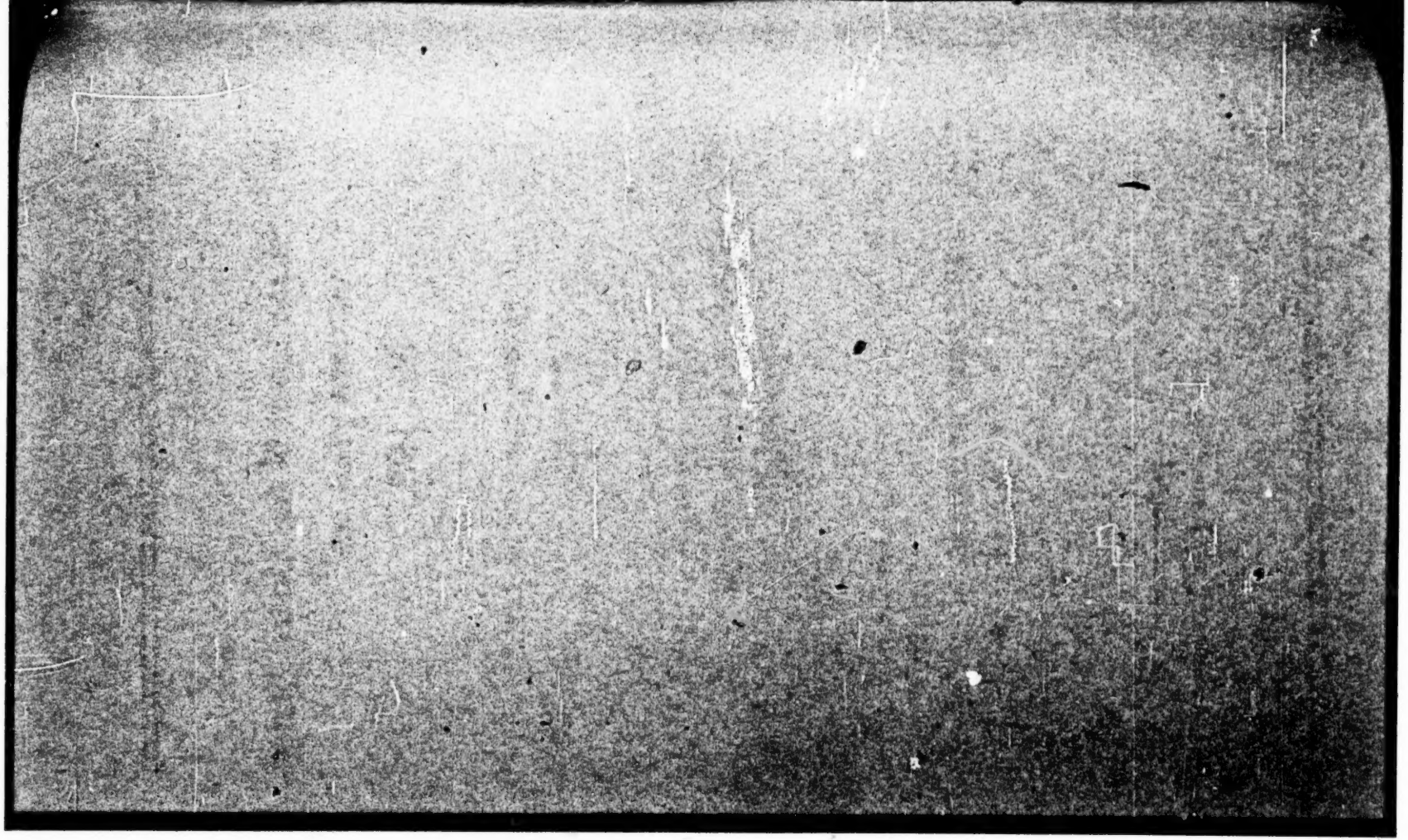

In the Supreme Court of the United States

OCTOBER TERM, 1929.

No. 198.

THE ALUMINUM CASTINGS COMPANY,
Petitioner,

vs.

CARL F. ROUTZAHN, Individually and as
Collector of Internal Revenue,
Respondent.

BRIEF OF PETITIONER.

JOHN T. SCOTT,
Counsel for Petitioner.

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In the Supreme Court of the United States

OCTOBER TERM, 1929.

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THE ALUMINUM CASTINGS COMPANY,
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Collector of Internal Revenue,
Respondent.

BRIEF OF PETITIONER.

I.

OPINIONS OF THE COURTS BELOW.

The opinion of the United States District Court for the Northern District of Ohio, Eastern Division, is reported in 24 Fed. Rep. (2d) 230. The opinion of the United States Circuit Court of Appeals for the Sixth Circuit is reported in 31 Fed. Rep. (2d) 669, and is found in the Transcript of the Record in this case at page 151.

II.

JURISDICTION.

This proceeding is on writ of certiorari, granted October 21, 1929, to the United States Circuit Court of Appeals for the Sixth Circuit, under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925 (43 Stat. 938). The date of the judgment to be reviewed is April 2, 1929 (See Record, p. 151).

III.

STATEMENT OF THE CASE.

In the year 1916, the petitioner, an Ohio corporation, manufactured articles from which it derived a profit which was held to be subject to the tax imposed by Title III of the Revenue Act of 1916 and known as the munitions manufacturers' tax. The so-called munitions manufacturers' tax of the petitioner, imposed on profits made on munitions manufactured and sold in the year 1916, in the sum of $246,275.63, was paid to the United States Government by the petitioner in the year 1917. In its Federal income tax return for the year 1916, the petitioner did not deduct the said munitions manufacturers' tax from its gross income because said munitions manufacturers' tax was not paid in said year; but, having paid the said munitions manufacturers' tax in 1917, the petitioner deducted said tax from its gross income in its Federal income and profits tax returns filed with the United States Internal Revenue Department for the year 1917. The Commissioner of Internal Revenue disallowed the said munitions manufacturers' tax of $246,275.63, paid by the petitioner in the year 1917, as a deduction from the gross income of the petitioner for the year 1917, and transferred it back as a deduction from the gross income of the petitioner for the year 1916, in figuring the income and profits taxes of the petitioner for said years, and also deducted the amount of said munitions manufacturers' tax from the invested capital of the petitioner for the year 1917. The question at issue in this case is whether this action of the Commissioner of Internal Revenue (which resulted in a net increase of petitioner's Federal income and profits taxes for the years 1916 and 1917 of $175,053.35), was correct or incorrect. If incorrect, the petitioner, under the stipulation of facts made in this case, is admittedly entitled to recover from the respondent in this action the sum of $166,910.01, together with interest

thereon from July 14, 1923, at the rate of 6% per annum. (See Stipulation of Facts, Record, pp. 28-30.)

The case was tried to the District Court, a jury being waived in writing pursuant to the provisions of Section 649 of the Revised Statutes of the United States; and special findings of fact were duly requested by the parties and made by the District Court. (See Record, pp. 7-21 and 24-26.) The District Court rendered judgment for the respondent, which was affirmed by the Circuit Court of Appeals for the Sixth Circuit on April 2, 1929. (See Record, pp. 26 and 151.)

The facts involved in the case at issue are undisputed* and are as follows:

The Internal Revenue Law of 1913 (enacted October 3, 1913) provided as follows (Section G (b)) (38 Stat. 172):

> "Such net income shall be ascertained by deducting from the gross amount of the income of such corporation, joint-stock company or association, or insurance company, received within the year from all sources,
>
> (first) all the ordinary and necessary expenses paid within the year in the maintenance and operation of its business and properties, including rentals or other payments required to be made as a condition to the continued use or possession of property;
>
> (second) all losses actually sustained within the year and not compensated by insurance or otherwise, including a reasonable allowance for depreciation by use, wear and tear of property, if any; * * *
>
> (third) the amount of interest accrued and paid within the year on its indebtedness to an amount of such indebtedness not exceeding one-half of the sum of

---

* See Record, p. 49, where the District Court said, "I cannot see that you folks differ about anything here as to the real facts," and Record, p. 10, where the District Court in its Memorandum Opinion said, "The facts on which this issue turns, are not really in dispute," and Record, p. 153, where the Circuit Court of Appeals said, "Since all facts are conceded, * * *."

its interest bearing indebtedness and its paid-up capital stock outstanding at the close of the year, or if no capital stock, the amount of interest paid within the year on an amount of its indebtedness not exceeding the amount of capital employed in the business at the close of the year; * * *

(fourth) all sums paid by it within the year for taxes imposed under the authority of the United States or of any State or Territory thereof, or imposed by the Government of any foreign country."

Under the Internal Revenue Law of 1913, the only recognized basis for making income tax returns was that of actual receipts and disbursements (See Law Opinion 1059, Record, pp. 125 and 132, and argument of the Solicitor General, 269 U. S. 423, hereinafter quoted), and thereunder the Commissioner of Internal Revenue made the following rulings:

Regulations 33, Art. 156 (See Record, p. 133):

"Reserves for taxes cannot be allowed, as the law specifically provides that only such sums as are paid within the year for taxes shall be deducted."

Regulations 33, Art. 158 (See Record, p. 133):

"Deductions for taxes, however, should be the aggregate of the amounts actually paid, as shown on the cash book of the corporation."

A similar ruling was made as to interest.

Regulations 33, Art. 148 (See Record, p. 133):

"The interest to be deductible must have been computed on the proper principal at the contract rate and must have been actually paid within the year."

While the United States Internal Revenue Law of 1913 required income tax returns to be made on the actual receipt and disbursement basis and the Regulations issued by the Commissioner of Internal Revenue specifically provided that reserves for taxes could not be allowed and that

interest and taxes could be deducted from gross income only in the year when actually paid, yet the Regulations issued by the Commissioner of Internal Revenue required that the gross income of manufacturing companies should consist of the total sales of manufactured goods during the year covered by the return, increased or decreased by the gain or loss as shown by the inventories of finished and unfinished products, raw material, etc., at the beginning and end of the year, and the Commissioner of Internal Revenue ruled that accounts and bills receivable of a corporation were to be treated as income for the year in which they were created, that is to say, in the year in which the accounts were set up on the books or the bills receivable were accepted, and that accounts payable, representing the ordinary and necessary expenses of maintaining and operating the corporation's business and property, might be deducted from the gross income of the year in which the expenses were incurred.

See Regulations 33, Art. 104 (Record, p. 134), which provides as follows:

> "Gross income of manufacturing companies shall consist of the total sales of manufactured goods during the year covered by the return, increased or decreased by the gain or loss as shown by the inventories of finished and unfinished products, raw material, etc., at the beginning and end of the year."

and letter addressed to Carey, Piper and Hall, Baltimore, Maryland, signed by Acting Commissioner David A. Gates and dated March 2, 1915 (Record, p. 133), wherein the Acting Commissioner says:

> "Accounts payable, representing ordinary and necessary expenses of maintaining and operating the business and property of a corporation, if actually charged into the Expense Account and so entered on the books as to constitute a liability against the assets of the company, and so treated in the preparation of

the return of annual net income that they will not be included in the deductions in the year in which they are actually paid in cash, or its equivalent, such accounts payable may be deducted from the gross income of the year in which the expenses were incurred.

"This ruling applies only to accounts payable representing ordinary and necessary expenses of maintaining and operating the business, that is, to such expenses as are incurred by the corporation in producing the gross income which it is required to return.

"Accounts and bills receivable of a corporation are to be treated as income for the year in which they are created, that is to say, in the year in which the accounts are set up on the books or the bills receivable are accepted."

From the foregoing, it will be seen that the rulings of the Commissioner of Internal Revenue under the Internal Revenue Act of 1913 were that the income tax returns under that law must be made on an actual receipt and disbursement basis, but that manufacturing corporations were not only permitted, but obliged by the method of computing gross income required by Art. 104 of Regulations 33 promulgated by the Commissioner of Internal Revenue, to use inventories and to treat bills and accounts receivable and payable representing sales of products and purchases of materials and other costs of goods as actual receipts and disbursements. In other words, the Commissioner of Internal Revenue ruled that the actual receipt and disbursement basis of figuring and reporting income, required by the Internal Revenue Law of 1913, was not violated by using inventories or by treating bills and accounts receivable and payable arising from its manufacturing operations as actual receipts and disbursements of the dates when they were entered on the company's books.

Pursuant to the foregoing regulations and rulings of the Commissioner of Internal Revenue, the petitioner re-

ported its income for the year 1915, in its Federal income tax return for that year, on the basis of cash receipts and disbursements, using inventories in figuring gross income and treating its ordinary bills and accounts receivable and payable, arising in the operation of its manufacturing business, as cash receipts and disbursements on the dates on which they were entered on the Company's books (See Record, pp. 32, 34 and 35).

On September 8, 1916, a new Federal income tax law was passed. This law contained the following provisions (39 Stat. 767):

> "Sec. 12. (a) In the case of a corporation, joint-stock company or association, or insurance company, organized in the United States, such net income shall be ascertained by deducting from the gross amount of its income received within the year from all sources—
>
> First. All the ordinary and necessary expenses paid within the year in the maintenance and operation of its business and properties, including rentals or other payments required to be made as a condition to the continued use or possession of property to which the corporation has not taken or is not taking title, or in which it has no equity.
>
> Second. All losses actually sustained and charged off within the year and not compensated by insurance or otherwise, including a reasonable allowance for the exhaustion, wear and tear of property arising out of its use or employment in the business or trade; * * *
>
> Third. The amount of interest paid within the year on its indebtedness to an amount of such indebtedness not in excess of the sum of (a) the entire amount of the paid-up capital stock outstanding at the close of the year, or, if no capital stock, the entire amount of capital employed in the business at the close of the year, and (b) one-half of its interest-bearing indebtedness then outstanding; * * *

Fourth. Taxes paid within the year imposed by the authority of the United States, or its Territories, or possessions, or any foreign country, or under the authority of any State, county, school district, or municipality, or other taxing sub-division of any State, not including those assessed against local benefits."

It will be noted that the above quoted provisions of Section 12(a) of the Internal Revenue Law of September 8, 1916, are substantially identical with the corresponding provisions of Section G(b) of the Internal Revenue Law of 1913 hereinabove quoted.

The Internal Revenue Law of 1916 also provided as follows:

Sec. 13. (39 Stat. 771)

* * * * *

"(d) A corporation, joint-stock company or association, or insurance company, keeping accounts upon any basis other than that of actual receipts and disbursements, unless such other basis does not clearly reflect its income, may, subject to regulations made by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, make its return upon the basis upon which its accounts are kept, in which case the tax shall be computed upon its income as so returned;"

On September 14, 1916, W. H. Osborn, Commissioner of Internal Revenue, issued the following ruling (See Record, p. 134):

"Pending the adoption and promulgation of special regulations under the Act of September 8, 1916, Income Tax Regulations in force September 8, 1916, are hereby extended and made applicable to the Act of September 8, 1916, so far as not inconsistent with the provisions of that statute."

On January 8, 1917, the Commissioner of Internal Revenue made the following ruling, T. D. 2433 (See Record, pp. 134-136):

"Sub-paragraph (d) of Sec. 13, of Title I, of the Act of September 8, 1916, provides that

> 'A corporation, joint stock company or association, or insurance company, keeping accounts upon any basis other than that of actual receipts and disbursements, unless such other basis does not clearly reflect its income, may, subject to regulations made by the Commissioner of Internal Revenue with the approval of the Secretary of the Treasury, make its returns upon the basis upon which its accounts are kept, in which case the tax shall be computed upon its income as so returned.'

"Under this provision it will be permissible for corporations which accrue on their books monthly or at other stated periods, amounts sufficient to meet fixed annual or other charges, to deduct from their gross income the amounts so accrued, provided such accruals approximate as nearly as possible the actual liabilities for which the accruals are made, and provided that in cases wherein deductions are made on the accrual basis as hereinbefore indicated, income from fixed and determinable sources accruing to the corporations must be returned, for the purpose of the tax, on the same basis.

"In cases wherein, pursuant to the consistent practice of accounting of the corporation, * * * corporations set up and maintain reserves to meet liabilities, the amount of which and the date of payment or maturity of which, is not definitely determined or determinable at the time the liability is incurred, it will be permissible for the corporations to deduct from their gross income the amounts credited to such reserves each year, provided that the amounts deductible on account of the reserves shall approximate as nearly as can be determined, the actual amounts which experience has demonstrated would be necessary to discharge the liabilities incurred during the year and for the payment of which additions to the reserves were made; * * *

* * * * *

> "If, upon investigation, it shall be found that returns made upon the basis of accruals and reserves, do not reflect the true net income, the corporation so failing in this way to return the true net income, will not thereafter be permitted to make its returns upon any basis other than that of actual receipts and disbursements."

It will be noted that the utmost effect that can be given to Sec. 13(d) of the Act of September 8, 1916, is simply that corporations which have kept their accounts on a basis other than that of actual receipts and disbursements, but have theretofore been obliged by law to report their income on an actual receipt and disbursement basis, are now permitted, if they so desire, to report their income upon the basis upon which they have kept their accounts. Section 13(d), however, in no way compels corporations under any circumstances to report their income on other than an actual receipt or disbursement basis, no matter how they have kept their books.

The Treasury Department's rulings and regulations, hereinabove quoted, remained unchanged down to and after July 12, 1917, the date when the petitioner's amended income tax return for the year 1916 was executed.

On account of the petitioner's bookkeeping department being behind in its work, the petitioner was obliged, in the first instance, to file a tentative, inaccurate return of income for the year 1916, and as soon as correct figures were available, to wit, in July, 1917, the petitioner filed an amended income tax return for 1916, which was made up by the petitioner's secretary and auditor in conjunction with a government auditor who was then at the petitioner's plant auditing the figures for the petitioner's income tax return and munitions manufacturers' tax return for the year 1916. (See Record, pp. 31, 32 and 37.)

The petitioner's amended income tax return for the year 1916 was made out as follows: The gross income from operations was figured in the method required by the form of Item 3(a) on the reverse side of the income tax return blank furnished by the Treasury Department, and the petitioner's ordinary bills and accounts receivable and payable, arising from its manufacturing operations, were treated as cash receipts and disbursements on the dates when they were entered on the books, and the other items, including rentals and interest and taxes, were actual cash receipts and disbursements during the year. (See Record, pp. 31, 32, 34, 35, 36-40, 69 and 73.) The petitioner's secretary was familiar with the Treasury Department's regulations and rulings governing actual receipt and disbursement returns (See Record, pp. 33, 34 and 38); and a comparison of the petitioner's income tax return with the Treasury Department's regulations and rulings hereinabove cited will disclose that the petitioner's amended income tax return was made out in exact compliance with the Treasury Department's regulations and rulings then governing actual receipt and disbursement returns (See Record, p. 38).

The petitioner's amended income tax return for the year 1916, thus made out and filed by the petitioner in collaboration with the Internal Revenue Department's auditor, figured the income very differently from the income shown on the petitioner's books of account (See *infra*, pp. 12-13, as to the books of account) in that, subject to the questions, hereinafter discussed, as to the method of figuring gross income from operations by the use of inventories and the treatment of ordinary bills and accounts receivable and payable, arising from the petitioner's manufacturing operations, as cash receipts and disbursements, the accruals and reserves on the petitioner's books of account were omitted in figuring the petitioner's income tax return (See

Record, pp. 32, 35 and 36-37). For example, the taxes actually paid by the petitioner during the year 1916 and the taxes deducted in the petitioner's income tax return for the year 1916 amounted to $26,493.44 (See Record, pp. 32 and 84); whereas the taxes accrued, or for which reserves were set up, on the petitioner's books, during the year 1916, amounted to $130,924.19 (See Record, pp. 37 and 51 and Plaintiff's Exhibit No. 5, following p. 122).

The petitioner made out its amended income tax return for the year 1916 in exactly the same way as it had done the previous year (See Record, p. 34), and did not elect to avail itself of the privilege granted by Section 13(d) of the Act of September 8, 1916, to make its return upon the basis upon which its accounts were kept, unless, as contended by the respondent, the filing of said return, in itself, conclusively constituted such election, the petitioner's intention to the contrary notwithstanding (See Record, p. 32). Moreover, in answer to the question on the income tax return blank for the year 1916, "State whether or not this return is made on the basis of actual receipts and disbursements," the petitioner answered, "Yes." (See Record, p. 81). The petitioner's amended income tax return for the year 1916 was audited and approved, as filed, by the Treasury Department, and this audit and approval has never since been modified or questioned by the Treasury Department except as to the one item of the munitions manufacturers' tax deduction (See Record, pp. 32 and 37).

During the years 1916 and 1917 and previous thereto, the entries in the petitioner's books of account were made as follows: The entries in some accounts were made on the so-called "accrual basis"; the entries in some accounts were made when the invoices of the items were made out or received by the petitioner; and the entries in some accounts were made on the basis of actual cash receipts and

disbursements. That the foregoing statement is true is amply shown by the petitioner's testimony (See Record, pp. 32, 34, 39 and 41) and expressly admitted by one of the respondent's accountants who testified in this case (See Record, p. 46).

The munitions manufacturers' taxes of the petitioner were never accrued on its books, nor were any reserves ever set up against its munitions manufacturers' taxes (See Record, p. 29),—the petitioner's munitions manufacturers' taxes being one of the accounts set up on the petitioner's books on an actual receipt and disbursement basis. The first and only entry with reference to the munitions manufacturers' tax, which appears on the petitioner's books, was in July, 1917, when the payment of the tax was entered on the petitioner's books on the date when it was actually paid (See Record, pp. 33 and 40).

On October 3, 1917, paragraphs third and fourth of Subdivision (a) of Section 12 of the Act of September 8, 1916, were amended so as to read as follows, the italics indicating the words and clauses added by amendment (40 Stat. 335):

> "Third. The amount of interest paid within the year on its indebtedness (*except on indebtedness incurred for the purchase of obligations or securities the interest upon which is exempt from taxation as income under this title*) to an amount of such indebtedness not in excess of the sum of (a) the entire amount of the paid-up capital stock outstanding at the close of the year, or, if no capital stock, the entire amount of capital employed in the business at the close of the year, and (b) one-half of its interest-bearing indebtedness then outstanding:
>
> * * * *
>
> "Fourth. Taxes paid within the year imposed by the authority of the United States (*except income and excess profits taxes*), or *of* its Territories, or possessions, or any foreign country, or *by* (under) the au-

thority of any State, county, school district, or municipality, or other taxing subdivision of any State, not including those assessed against local benefits."

It will be noted that the only substantial change in the clause covering the deduction of taxes is that Federal income and excess profits taxes are excepted from the taxes which may be deducted from gross income in figuring taxable income.

On December 17, 1917, the Commissioner of Internal Revenue issued the following ruling (See Record, p. 136):

> "These provisions of law (Sec. 13(d) of the Act of September 8, 1916) authorize corporations and joint stock companies, or associations, and insurance companies, keeping books of account on an accrued basis, to deduct from gross income in returns of annual net income the accrual of interest for the return year within the limits prescribed by the taxing acts when shown as a charge against accrued income upon the books of account."

Here again it will be noted that the change from an actual receipt and disbursement basis to an accrual basis, in making income tax returns, is purely permissive and not obligatory.

There were no other pertinent income tax rulings made prior to March, 1918, when the income tax returns for the year 1917 had to be filed, Article 191 of Regulations 33, as it stood in March, 1918, reading as follows (See Record, p. 136):

> "*Taxes deductible.*—Taxes imposed against a corporation by authority of the United States (except income and excess-profits taxes) its territories or any foreign country, or by authority of any State, county, school district, municipality, or other taxing sub-division of a State (not including those assessed against local benefits) and paid within the year for which the return is made, are deductible from the gross income of a domestic corporation."

The petitioner made out its income tax return for the year 1917 in exactly the same way that it had made out its income tax returns for the years 1915 and 1916, in strict compliance with the then regulations of the Treasury Department, governing actual receipt and disbursement returns, and the requirements of the income tax return blank (See particularly item 4(a), Record, p. 93) which the Treasury Department required to be used, and did not elect to avail itself of the privilege granted by Section 13(d) of the Act of September 8, 1916, to make its return upon the basis upon which its accounts were kept, unless, as contended by the respondent, the filing of said return, in itself, conclusively constituted such election, the petitioner's intention to the contrary notwithstanding (See Record, pp. 31, 32, 34-35, 37, 38 and 39). Moreover, in answer to the question on the 1917 income tax return blank, "Is this return made on the basis of actual receipts and disbursements?" the petitioner answered, "Yes, except as below indicated," and below it is stated that "Bills and accounts payable and receivable are treated as receipts and disbursements." (See Record, p. 98.)

IV.

SPECIFICATION OF ERRORS.

The petitioner duly excepted to the findings of fact and conclusions of law made by the District Court and to the judgment rendered by the District Court and to the failure of the District Court to make various findings of fact requested by the petitioner; but, as hereinabove set forth in the Statement of the Case, there is no dispute about the facts in this case and the ultimate question raised by the various exceptions taken by the petitioner is whether or not, on the established facts, the petitioner is entitled to judgment in this case, and the argument in this Brief will be addressed directly to this question.

V.

SUMMARY OF ARGUMENT.

UNDER THE UNITED STATES INTERNAL REVENUE LAW OF 1913, INCOME TAX RETURNS HAD TO BE MADE ON THE ACTUAL RECEIPT AND DISBURSEMENT BASIS, BUT THE REGULATIONS ISSUED BY THE COMMISSIONER OF INTERNAL REVENUE REQUIRED MANUFACTURING COMPANIES TO FIGURE GROSS INCOME BY THE USE OF INVENTORIES AND THE COMMISSIONER OF INTERNAL REVENUE RULED THAT ACCOUNTS AND BILLS RECEIVABLE OF A CORPORATION WERE TO BE TREATED AS INCOME FOR THE YEAR IN WHICH THE ACCOUNTS WERE SET UP ON THE BOOKS OR THE BILLS RECEIVABLE WERE ACCEPTED AND THAT ACCOUNTS PAYABLE, REPRESENTING THE ORDINARY AND NECESSARY EXPENSES OF MAINTAINING AND OPERATING THE CORPORATION'S BUSINESS AND PROPERTY, MIGHT BE DEDUCTED FROM THE GROSS INCOME OF THE YEAR IN WHICH THE EXPENSES WERE INCURRED. RETURNS THUS MADE WERE REGARDED AND ACCEPTED BY THE COMMISSIONER OF INTERNAL REVENUE AS MADE ON THE BASIS OF ACTUAL RECEIPTS AND DISBURSEMENTS. THE UNITED STATES INTERNAL REVENUE LAW OF 1916 WAS SUBSTANTIALLY THE SAME, SO FAR AS PERTINENT TO THE CASE AT ISSUE, AS THE REVENUE LAW OF 1913, EXCEPT FOR THE OPTION GIVEN THE TAXPAYER AS HEREINAFTER SET FORTH; AND THE REGULATIONS ISSUED BY THE COMMISSIONER OF INTERNAL REVENUE UNDER THE REVENUE LAW OF 1913 WERE BY THE COMMISSIONER EXPRESSLY MADE APPLICABLE TO THE REVENUE LAW OF 1916. WHILE THE REVENUE LAW OF 1916 ALLOWED THE TAXPAYER TO MAKE ITS INCOME TAX RETURNS ON THE SAME ACTUAL RECEIPT AND DISBURSEMENT BASIS AS THE REVENUE LAW OF 1913, THE REVENUE LAW OF 1916 GAVE AN OPTION TO A CORPORATION KEEPING ACCOUNTS ON ANY BASIS OTHER THAN THAT OF ACTUAL RECEIPTS AND DISBURSEMENTS TO MAKE ITS INCOME TAX RETURNS UPON THE BASIS UPON WHICH ITS ACCOUNTS WERE KEPT. IN THE CASE AT ISSUE, THE PETITIONER NEVER EXERCISED THIS OPTION, BUT, ON THE CONTRARY, MADE OUT ITS INCOME TAX RETURNS FOR THE YEARS 1916 AND 1917 AS ACTUAL RECEIPT AND DISBURSEMENT RETURNS, IN EXACT AND COMPLETE COMPLIANCE WITH THE REGULATIONS AND RULINGS OF THE COMMISSIONER OF INTERNAL REVENUE THEN GOVERN-

ING ACTUAL RECEIPT AND DISBURSEMENT RETURNS, AND EXACTLY LIKE THE PETITIONER'S RETURNS UNDER THE REVENUE LAW OF 1913,—THE PETITIONER'S INCOME TAX RETURNS FOR THE YEARS 1916 AND 1917 REPORTING ACTUAL CASH RECEIPTS AND DISBURSEMENTS, SUBJECT TO THE USE OF INVENTORIES AND THE TREATMENT OF ACCOUNTS AND BILLS RECEIVABLE AND PAYABLE, AS ABOVE SET FORTH, A USE AND TREATMENT WHICH WERE THEN NOT ONLY PERMITTED BUT REQUIRED BY THE COMMISSIONER OF INTERNAL REVENUE IN ACTUAL RECEIPT AND DISBURSEMENT RETURNS. MOREOVER, THE PETITIONER'S INCOME TAX RETURNS FOR THE YEARS 1916 AND 1917 FIGURED THE INCOME VERY DIFFERENTLY FROM THE INCOME SHOWN ON THE PETITIONER'S BOOKS OF ACCOUNT, IN THAT THE ACCRUALS AND RESERVES SET UP ON THE PETITIONER'S BOOKS WERE ELIMINATED IN MAKING OUT THE TAX RETURNS AND THE TAX RETURNS WERE MADE SHOWING ACTUAL CASH RECEIPTS AND DISBURSEMENTS, SUBJECT TO THE USE OF INVENTORIES AND THE TREATMENT OF BILLS AND ACCOUNTS RECEIVABLE AND PAYABLE AS HEREINABOVE SET FORTH. MOREOVER, THE PETITIONER, IN ITS INCOME TAX RETURN FOR THE YEAR 1916, EXPLICITLY STATED THAT THE RETURN WAS MADE ON THE BASIS OF ACTUAL RECEIPTS AND DISBURSEMENTS, AND IN ITS INCOME TAX RETURN FOR THE YEAR 1917, EXPLICITLY STATED THAT THE RETURN WAS MADE ON THE BASIS OF ACTUAL RECEIPTS AND DISBURSEMENTS EXCEPT THAT BILLS AND ACCOUNTS PAYABLE AND RECEIVABLE WERE TREATED AS RECEIPTS AND DISBURSEMENTS. UNDER THE FOREGOING CIRCUMSTANCES, THE EVIDENCE IS CONCLUSIVE THAT THE PETITIONER MADE OUT ITS INCOME TAX RETURNS FOR THE YEARS 1916 AND 1917 ON THE ACTUAL RECEIPT AND DISBURSEMENT BASIS AS THEN PRESCRIBED BY THE COMMISSIONER OF INTERNAL REVENUE, AND DID NOT ELECT TO MAKE ITS INCOME TAX RETURNS ON THE BASIS ON WHICH ITS ACCOUNTS WERE KEPT OR ON THE SO-CALLED "ACCRUAL BASIS."

EVEN IF WE ASSUME THAT IT WAS IMPROPER FOR THE PETITIONER IN AN ACTUAL RECEIPT AND DISBURSEMENT RETURN TO USE INVENTORIES IN FIGURING ITS GROSS INCOME FROM OPERATIONS AND TO TREAT ACCOUNTS RECEIVABLE AND PAYABLE, ARISING OUT OF ITS MANUFACTURING OPERATIONS, AS CASH RECEIPTS AND DISBURSEMENTS ON THE DATES WHEN

THEY WERE ENTERED ON THE BOOKS, YET THE PETITIONER'S INCOME TAX RETURNS FOR THE YEARS 1916 AND 1917 HAVING BEEN AVOWEDLY MADE ON THE ACTUAL RECEIPT AND DISBURSEMENT BASIS AND HAVING BEEN MADE IN EXACT CONFORMITY WITH THE THEN REGULATIONS AND RULINGS OF THE COMMISSIONER OF INTERNAL REVENUE GOVERNING ACTUAL RECEIPT AND DISBURSEMENT RETURNS, THE ONLY CORRECTION, IF ANY, THAT THE COMMISSIONER OF INTERNAL REVENUE COULD PROPERLY HAVE MADE, IF HE HAD AFTERWARD CHANGED THE TREASURY DEPARTMENT REGULATIONS AND RULINGS, WAS TO CORRECT THE INCOME TAX RETURNS ON THE BASIS ON WHICH THEY WERE INTENDED TO BE MADE, TO WIT, THE ACTUAL RECEIPT AND DISBURSEMENT BASIS.

EVEN IF WE ASSUME THAT THE PETITIONER HAD ELECTED TO MAKE ITS INCOME TAX RETURNS FOR THE YEARS 1916 AND 1917 ON THE SAME BASIS ON WHICH ITS ACCOUNTS WERE KEPT, THE MUNITIONS MANUFACTURERS' TAX WOULD NOT HAVE BEEN DEDUCTED IN THE YEAR 1916 BUT IN THE YEAR 1917; FOR THE PETITIONER'S ACCOUNTS WERE KEPT ON SUCH BASIS THAT THE PETITIONER'S MUNITIONS MANUFACTURERS' TAX ACCOUNT WAS ENTERED ON ITS BOOKS ONLY ON AN ACTUAL DISBURSEMENT BASIS AND NOT ON AN ACCRUAL BASIS.

VI.

ARGUMENT.

The decision in the case at issue depends on the proper construction and scope to be given to the decisions and opinion of this Court in the cases of *United States vs. Anderson* and *United States vs. Yale and Towne Manufacturing Company*, 269 U. S. 422. In these cases, it was held as stated in the syllabus:

> "1. The Revenue Act of 1916 imposed a tax on net income and profits ascertained by deducting from gross income, expenses paid, losses sustained, interest and taxes paid during the calendar year, but provided, § 13(d), that 'a corporation * * * keeping accounts upon any basis other than that of actual receipts and disbursements, unless such other basis does not clearly reflect its income, may, subject to regulations of the

Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, make its return upon the basis upon which its accounts are kept, in which case the tax shall be computed upon its income as returned.'

"*Held,* that where the taxpayer's books, reflecting its income, were kept upon an 'accrual' basis, i.e., by charging against income earned during the taxable period (1916) the expenses incurred in and attributable to the process of earning income during that period, and made its return upon that basis and not the basis of actual receipts and disbursements, it was permitted under the statute, as correctly construed by a Treasury regulation, to include in its deductions the amount of a 'reserve' entered on its books for taxes imposed by the United States on the profits of munitions made and sold by the taxpayer during that year, although the tax had not 'accrued' in the sense of having been assessed and become due; and that it was not permissible, as the taxpayer attempted, to defer deduction of the tax until the income return for the following year, during which the tax became due and was paid. Pp. 438, 441."

The courts below construed the opinion of this Court in the *Anderson* and *Yale and Towne Manufacturing Company* cases as holding that the combined effect of Sections 12(a) and 13(d) of the Internal Revenue Act of 1916 was that if the taxpayer "failed or was unable" to make its income tax return on a "*strict*" receipts and disbursements basis, the taxpayer was *required* to make its return on the "accrual basis"; that inventories and bills and accounts payable and receivable are not properly used in a "*strict*" receipts and disbursements return, and that, therefore, where the taxpayer used inventories and treated any bills and accounts receivable and payable as cash receipts and disbursements in its income tax returns, it had failed to make a return on a "*strict*" receipts and dis-

bursements basis and consequently its return must be made on an "accrual basis." This construction is based on the following italicized *obiter dicta* in this Court's opinion:

> "Standing by themselves and taken at their face value, these sections (Sections 12(a) and 13(d) of the Internal Revenue Act of 1916) would seem to require the taxpayer to make his return on the basis of receipts and disbursements or, in the alternative, on the basis of its own books of account if they reflect true income, under such regulations as the Commissioner may make, *and indeed to require the latter alternative if the taxpayer is unable to make his return on that basis.*" (269 U. S. 437)

and

> "It was to enable taxpayers to keep their books and make their returns according to scientific accounting principles, by charging against income earned during the taxable period, the expenses incurred in and properly attributable to the process of earning income during that period; *and indeed, to require the tax return to be made on that basis, if the taxpayer failed or was unable to make the return on a strict receipts and disbursements basis.*" (269 U. S. 440)

We respectfully challenge the accuracy and the soundness of the foregoing *obiter dicta,* and submit that the italicized statements could not possibly be correct statements of the law.

Section 12(a) of the Internal Revenue Act of 1916, like Section G(b) of the Internal Revenue Law of 1913, provided for an actual receipt and disbursement return. Section 13(d) of the Internal Revenue Act of 1916 merely gave to the taxpayer an option to make its income tax return on the basis on which its accounts were kept. This option the taxpayer might or might not exercise, as it deemed for its own best interests. *There is absolutely nothing in the law which can possibly be construed as*

obliging the taxpayer to exercise the option under any circumstances. There is nothing in the law which can possibly be construed as providing that in case the taxpayer "fails or is unable" properly to make out a "strict" receipt and disbursement return, then the Commissioner of Internal Revenue may compel the taxpayer to make out a return on the basis of the taxpayer's accounts. The law did not recognize any inability on the part of the taxpayer to make an actual receipt and disbursement return. During the period of seven years from 1909 to 1915 inclusive, all corporations were *required* to make out their excise and income tax returns on the actual receipt and disbursement basis. What was possible during the years 1909 to 1915 certainly was possible during the years 1916 *et seq.* Also, it may be noted that neither Section G(b) of the Internal Revenue Law of 1913 nor Section 12(a) of the Internal Revenue Act of 1916 provided for a "*strict*" receipt and disbursement return; for the deduction of depreciation was specifically allowed by the express provisions of each of these Sections. The receipt and disbursement returns required by Section G(b) of the Internal Revenue Law of 1913 and Section 12(a) of the Internal Revenue Act of 1916 have sometimes, not inaptly, been called "statutory" receipt and disbursement returns. It may, also, be mentioned that, as a matter of fact, it is certainly possible for any taxpayer keeping books of account on any basis to make an absolutely "strict" cash receipt and disbursement tax return. All one has to do is to use the entries of cash receipts and disbursements on the books. An actual receipts and disbursements basis may distort income to some extent as between different years, but if this be objectionable, the defect was in the laws permitting actual receipt and disbursement returns,—a defect which it is not the province of the courts to rectify. It may be added that in the Act of 1918, the Commissioner of Internal Revenue was

given power to redetermine the taxpayer's income on such basis as he might prescribe (See excerpt from *American Can Co. vs. United States,* cited *infra,* pp. 35-36), thus remedying the defect, if it be considered such, for 1918 and subsequent years. The petitioner therefore respectfully submits that it is a logical impossibility to say that the added option given the taxpayer in Section 13(d) of the Internal Revenue Act of 1916 could under any circumstances require the taxpayer to make its income tax returns on the basis of its accounts or on an accrual basis, if the taxpayer did not elect to do so.

As indicated by the foregoing discussion, the petitioner contends that the effects of Sections 12(a) and 13(d) of the Internal Revenue Act of 1916, upon the fair construction of this Court's opinion, as a whole, in the *Anderson* and *Yale and Towne Manufacturing Company* cases, are as follows:

Section 12(a) of the Internal Revenue Law of 1916 provided for an actual receipts and disbursements income tax return of exactly the same type and character as required by the Internal Revenue Law of 1913. Section 13(d) of the Internal Revenue Law of 1916 merely gave to the taxpayer an added option, which the taxpayer might or might not exercise, as it chose, to make its income tax return on the basis on which its accounts were kept. The initial question, therefore, is: Did the taxpayer make its return on an actual receipt and disbursement basis as that basis was then defined and required by the Treasury Department of the United States, or did the taxpayer elect to make its income tax return on the basis on which its accounts were kept? If the taxpayer elects to make its income tax return on the basis on which its accounts are kept, then the taxpayer must follow its accounts in making its income tax return; otherwise the taxpayer must make an actual receipt and disbursement return as then defined by the Treasury Department.

Cf. argument of Solicitor General Mitchell, found in 269 U. S. 423 and reading as follows:

> "Under the Revenue Act of 1916 a taxpayer was permitted to make his income tax return on an accrual basis if his books were kept on that basis. Corporation Excise Tax Law of 1909 plainly required the computation of net income on the basis of actual receipts and disbursements. There was no provision for accrual systems of accounting or for including items of expense incurred but not due and paid. The first corporation income tax Act of October 3, 1913, like the 1909 Act, provided for the calculation of net taxable income on the receipts and disbursements basis. Under these two Acts some departures from the strict receipts and disbursements basis were permitted by the Commissioner of Internal Revenue, such as the use of inventories. This legislation shows that the subject was undeveloped and the resulting system was a mongrel one, but, in the main, the returns were required to be made on a receipts and disbursements basis. *Lumber Mutual Fire Ins. Co. v. Malley,* 256 Fed. 380; *Maryland Casualty Co. v. United States,* 52 Ct. Cls. 201; same case, 251 U. S. 342. The first decided shift occurred in the Revenue Act of 1916, evidenced by the insertion of a new provision, § 13(d). This allowed the taxpayer the option to make his return on a cash basis without regard to how he kept his books, or if he kept his books on some other basis to make his return upon the basis upon which his accounts were kept."

In the case at issue, the petitioner made out its income tax returns for the years 1916 and 1917 on the basis of actual receipts and disbursements as then defined by the regulations and rulings of the Commissioner of Internal Revenue and in exact conformity with the Commissioner's regulations and rulings then governing actual receipt and disbursement returns, and the petitioner did not elect, under Section 13(d) of the Revenue Act of 1916, to make its

income tax returns on the basis on which its accounts were kept on its books.

As hereinabove shown in the Statement of the Case, the petitioner indisputably made out its income tax returns for the years 1916 and 1917 on the basis of actual receipts and disbursements, unless, as claimed by the respondent, the fact that the petitioner (to use the language of the respondent's witness) "used inventories in ascertaining their cost of goods, as well as the fact that they took the accounts receivable and the accounts payable in consideration as cash items," conclusively proves that the petitioner's income tax returns for the years 1916 and 1917 were made out on the so-called "accrual basis,"—it being the contention of the respondent that the method of arriving at gross income from operations by the use of inventories, in the manner set forth in Item 3(a) of the 1916 income tax return blank, and in Item 4(a) of the 1917 income tax return blank, plus the fact that bills and accounts receivable and payable arising in the course of the petitioner's manufacturing operations were treated as cash items on the dates when they were set up on the petitioner's books of account, render the petitioner's income tax returns for 1916 and 1917 so-called "accrual" returns and constituted an election on the part of the petitioner to avail itself of the privilege granted by Section 13(d) of the Revenue Act of 1916.

A review, however, of the regulations and rulings issued by the Commissioner of Internal Revenue prior to and during the years 1916 and 1917 and governing income tax returns for those years, shows clearly that the foregoing contention of the respondent is unsound. The Internal Revenue Law of 1913 *required* the taxpayer to make out income tax returns on the basis of actual receipts and disbursements (See Law Opinion 1059 and argument of

the Solicitor General, 269 U. S. 423, hereinabove quoted), and thereunder, as hereinabove set forth in detail in the Statement of the Case, while the regulations issued by the Commissioner of Internal Revenue provided that taxes, interest and other items must be reported for the years when the cash was spent out or taken in, yet these regulations *required* that the gross income of manufacturing companies, as reported in the income tax returns, should consist of the total sales of manufactured goods during the year covered by the return, increased or decreased by the gain or loss as shown by the inventories of finished and unfinished products, raw material, etc., at the beginning and end of the year, and the Commissioner of Internal Revenue ruled that accounts and bills receivable of a corporation *must* be treated as income for the year in which they were created, that is to say, in the year in which the accounts were set up on the books or the bills receivable were accepted, and that accounts payable, representing the ordinary and necessary expenses of maintaining and operating the corporation's business and property, might be deducted from the gross income of the year in which the expenses were incurred. The foregoing regulations and rulings under the Revenue Act of 1913, as hereinabove shown in the Statement of the Case, were by the Commissioner of Internal Revenue expressly extended to and continued in effect under the Revenue Act of 1916, which did not change or alter in any respect the right of the taxpayer to make its income tax returns upon the same actual receipt and disbursement basis which was required under the 1913 Act, but merely gave to a corporate taxpayer keeping accounts upon any basis other than that of actual receipts and disbursements an option, which it might or might not exercise, as the taxpayer deemed best, to make its income tax returns upon the basis upon which its accounts were kept.

The petitioner's income tax returns for the years 1916 and 1917 were made out by the petitioner's Secretary, who, at the time when he made out the returns, was familiar with the foregoing regulations and rulings, and these returns were made out by the petitioner's Secretary as actual receipt and disbursement returns, in exact conformity with the rulings and regulations of the Commissioner of Internal Revenue then governing such actual receipt and disbursement returns, and in exact compliance with the requirements of the form of income tax blanks furnished by the Internal Revenue Department and required to be used in making the income tax returns, and it was specifically stated on the income tax returns for the years 1916 and 1917 that the return was made on the basis of actual receipts and disbursements, it being added on the 1917 return that bills and accounts payable and receivable are treated as receipts and disbursements.

As above stated, there is no question but that the petitioner's income tax returns for the years 1916 and 1917 were actual receipt and disbursement returns, unless the two features testified to by the government's accountants, to wit, the use of inventories and the treatment of bills and accounts receivable and payable arising out of the petitioner's manufacturing operations, as cash receipts and disbursements, changed the returns into accrual returns. There can be no question but that the rulings and regulations of the Commissioner of Internal Revenue then in force were to the effect that these returns, as made out by the petitioner, were proper actual receipt and disbursement returns. There is no question but that the two features of the returns which are now claimed by the respondent to prevent the petitioner's returns from being actual receipt and disbursement returns, were features not only that the petitioner was then permitted to use in actual receipt and disbursement returns, but that the peti-

tioner *was then required* to use in actual receipt and disbursement returns, both by the regulations issued by the Commissioner of Internal Revenue, then in effect, and by the form of the income tax blanks required by the Internal Revenue Department to be used by the petitioner.* The petitioner's income tax returns for 1916 and 1917 were consequently proper actual receipt and disbursement returns *correctly* made out under the regulations and rulings of the Commissioner of Internal Revenue then in force, and thereunder, in such actual receipt and disbursement returns, taxes could be deducted only when paid.

The lower courts held that the foregoing argument had been rejected by this Court in the *Anderson* case (See Record, pp. 13 and 154).

In so holding, we submit that the lower courts have clearly fallen into error. The argument made in the *Anderson* case (See 269 U. S. 422, 438-439) was that inasmuch as the Treasury Regulations under the 1909 and 1913 Acts permitted the use of inventories and authorized the deduction of certain expenses although not paid, in ascertaining net income, but did not permit the deduction of taxes except in the year when paid, Congress by reenacting in §12(a) of the Act of 1916 the corresponding provisions of the earlier Acts, adopted the settled administrative practice, and that, accordingly, under that Act as well as under the earlier Acts, taxes could be deducted

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* It may be noted that when the Commissioner of Internal Revenue compelled the figuring of gross income from operations by adding sales and closing inventory and subtracting purchases and opening inventory, the Commissioner of Internal Revenue not only compelled the use of inventories, but also compelled the treatment of bills and accounts receivable, growing out of the sales, as cash receipts, and of bills and accounts payable, growing out of purchases of materials and other costs of goods, as cash disbursements; otherwise there would be a duplication in the receipts and in the expenditures used in figuring gross income, since the receipts and expenditures would be reported when the sales of products and purchases of materials were made, resulting in the creation of the accounts receivable and payable, and again when such accounts receivable and payable were paid.

only in the year when paid; but this Court said that Section 13(d) of the Act of 1916 gave to the taxpayer an option, not given in the earlier Acts, to report income on a different basis than that of actual receipts and disbursements, provided the taxpayer's books were kept on such different basis, and that, accordingly, a taxpayer keeping its books *and* reporting its income on an accrual basis must deduct taxes when accrued.

The argument advanced in the *Anderson* case is an entirely different argument than the proposition maintained by the petitioner in the case at issue. The petitioner in the case at issue does not maintain that it had no option to report taxes on the accrual basis if the tax accounts were kept in its books on that basis, but does maintain that the income tax returns filed by the petitioner for the years 1916 and 1917 were of the type and character that were then not only regarded but required by the Commissioner of Internal Revenue, as and for actual receipt and disbursement returns under the 1913 Act and the regulations issued thereunder, and under the 1916 Act and the Internal Revenue Commissioner's ruling of September 14, 1916, making the regulations under the 1913 Act applicable to the 1916 Act, and that it is impossible justly or logically to say that the petitioner, having made an income tax return of the type and character then prescribed and defined by the Commissioner of Internal Revenue for and as actual receipt and disbursement returns, can, by having filed such return, be deemed to have elected to make, or to have made, a so-called "accrual" return.

While it is not necessary to do so, we may call to the attention of the Court the fact that not only did the Treasury Department in 1916 and 1917 rule that manufacturing companies, in making out actual receipt and disbursement returns, *must* use inventories, but the United

States Government, through its Solicitor General, still maintains that this ruling is correct. See Brief recently filed with this Court by the Solicitor General in support of the petition of the United States for writs of certiorari in the cases of the United States, Petitioner, vs. American Can Company, the United States, Petitioner, vs. Missouri Can Company and the United States, Petitioner, vs. Detroit Can Company (October term, 1928, Nos. 128, 129 and 130), wherein the Solicitor General says (p. 20):

> "The case of *Doyle v. Mitchell Brothers Co., supra,* (247 U. S. 179) arose under the Corporation Excise Tax Act of August 5, 1909, which provided for the return of income on a cash receipts and disbursements basis only. The Court there said that the gross income of manufacturing companies 'should consist of the difference between the price received for the goods as sold and the cost of such goods as manufactured,' the cost to be ascertained by an addition of a charge to the account of goods as manufactured during the year of the sum of the inventory at the beginning of the year and a credit to the account of the sum of the inventory at the end of the year.
>
> "On a cash basis moneys spent for materials not used or sold during the year are not ordinary and necessary expenses but are investments in capital items and can not be deducted under the statutory provision any more than could the cost of the factory building. It is, therefore, necessary in computing income on a cash receipts and disbursements basis to take into account the increase or decrease in inventory during the year."

In the very recent case of *American Can Company vs. Bowers, Collector of Internal Revenue,* decided November 11, 1929, (Not yet officially reported—see the Corporation Trust Company's Standard Federal Tax Service (1929) Vol. 3, p. 8905) the United States Circuit Court of Appeals for the Second Circuit expressly holds that the regulations

issued by the Treasury Department, requiring the use of inventories in actual receipt and disbursement returns, were valid.

In this case the Court said:

> "Indeed, the appellants have failed to comply with the Departmental Regulation 33 (Revised) Articles 91 and 92, promulgated under the Act of 1917 which, in effect, require manufacturing and mercantile corporations to compute their income tax under the act in question through the use of inventories showing gross income as consisting of the difference between the price received for the goods sold and the cost of such goods as manufactured. *Such regulations are valid, whether applied to a cash or accrual basis of return.* (*Hays v. Gauley Mt. Coal Co.*, 247 U. S. 189)." (The Italics are ours.)

As hereinabove shown (footnote, p. 27), if gross income or cost of goods is required to be figured by the use of inventories as set forth in Item 3(a) of the 1916 income tax return blank and in Item 4(a) of the 1917 income tax return blank, such use of inventories also *compels* the treatment of bills and accounts receivable growing out of sales of products as cash receipts and of bills and accounts payable growing out of purchases of materials or other costs of goods as cash disbursements.

The authorities above cited seem ample to sustain the theoretical correctness, in accountancy, of the use of inventories and the treatment of bills and accounts receivable and payable arising out of manufacturing operations as cash receipts and disbursements, in "actual receipt and disbursement" returns, but, however this may be, as hereinabove set forth, the important indisputable fact is that such use and treatment were not only proper but required in actual receipt and disbursement returns under the rules and regulations of the Treasury Department for the years 1916 and 1917.

Suppose that the Internal Revenue Act of 1916 had contained Section 12(a) but not Section 13(d), would anybody contend that the petitioner's income tax returns for 1916 and 1917 were not proper receipt and disbursement returns under Section 12(a)? We think that surely no such contention would or could be made; for returns made out in the same identical manner as the petitioner's returns for 1916 and 1917 had been held to be proper receipt and disbursement returns for too many years. Yet how can the addition of Section 13(d), merely giving the taxpayer an option to make some other kind of return, render a return improper as a receipt and disbursement return under Section 12(a), which would be a proper receipt and disbursement return under Section 12(a) if Section 13(d) were not added?

It may be noted that the Circuit Court of Appeals, in its opinion in the case at issue, mentioned the item of depreciation as indicating an "accrual" return under Section 13(d) of the Internal Revenue Law of 1916, but this is clearly unsound for Section 12(a) of the Internal Revenue Law of 1916, like Section G(b) of the Internal Revenue Law of 1913, specifically provided for depreciation.

Even if there be a question as to the correctness of the use of inventories and the treatment of bills and accounts receivable and payable as actual receipts and disbursements, in actual receipt and disbursement returns, the evidence is conclusive that the petitioner never elected to change its income tax returns from the actual receipt and disbursement basis, required by the Law of 1913, to the basis on which its accounts were kept on its books, which was permitted by Section 13(d) of the Revenue Law of 1916. Besides the direct testimony of the petitioner's Secretary on this point (See Record, p. 32), the following facts are incontrovertible and decisive: The petitioner

never took any action under favor of said Section 13(d). It continued to keep its books of account after the passage of the Act of September 8, 1916, in exactly the same method that it had kept its books of account prior to the passage of the Act, and it continued to make its income tax returns to the Internal Revenue Department after the passage of the Act of September 8, 1916, in exactly the same manner in which it had made its returns prior to the passage of the Act. Furthermore, the petitioner neither before nor after the passage of the Act of September 8, 1916, made its income tax returns on the basis on which its accounts were kept. In the petitioner's books the entries in some accounts were cash receipt and disbursement entries; the entries in some accounts were made on the dates when the invoices of the items were made out or received by the petitioner; and the entries in some accounts were accruals and reserves. The petitioner's income tax returns figured the petitioner's income very differently from the income shown on the petitioner's books of account, in that the accruals and reserves set up on the petitioner's books of account were eliminated in making out the petitioner's income tax returns and the tax returns were made showing actual cash receipts and disbursements, subject to the use of inventories and the treatment of ordinary bills and accounts receivable and payable as hereinabove set forth. An example of the fact that the difference between the petitioner's books and the petitioner's income tax returns is not inconsiderable is found in the item of taxes for the year 1916. The taxes actually paid by the petitioner during the year 1916, and the taxes reported on the petitioner's income tax return for the year 1916 amounted to $26,493.44, whereas the taxes accrued or for which reserves were set up on the petitioner's books during the year 1916, amounted to $130,924.19. Moreover, the petitioner expressly declared in its income tax returns for 1916 and

1917 that the returns were made on a cash receipt and disbursement basis, adding in the 1917 return that bills and accounts receivable and payable are treated as receipts and disbursements.

Even if we assume that it was improper for a corporation, in an actual receipt and disbursement basis return, to use inventories in figuring its gross income from operations, and to treat its accounts receivable and payable, arising out of its manufacturing operations, as cash receipts and disbursements on the dates when they were entered on the books; even if we assume that the petitioner should have disobeyed the regulations and rulings promulgated by the Commissioner of Internal Revenue and disregarded the corporation income tax return blanks supplied by the Commissioner of Internal Revenue and by him required to be used by all corporations, and should have figured its gross income from operations without using inventories, and without considering sales of products or purchases of raw materials and the consequent bills and accounts receivable and payable; even on these assumptions, the only thing that the Commissioner of Internal Revenue had a right to do to correct the defect, was to correct the returns on an actual receipt and disbursement basis. The petitioner's income tax returns for 1916 and 1917 were avowedly made on an actual receipt and disbursement basis and it was so stated in the returns, and they were made in accordance with the then rules and regulations governing actual receipt and disbursement returns; and even if it be assumed that the items complained of by the respondent were not correctly reported in an actual receipt and disbursement return, the Commissioner of Internal Revenue had no right to shift the returns to an entirely new basis, but could properly correct the returns only on an actual receipt and disbursement basis,—the basis on which they were intended to be made.

Even if the petitioner had elected to make its income tax returns for the years 1916 and 1917 on the same basis as the basis on which its accounts were kept, the munitions manufacturers' tax would not have been deducted in the year 1916, but in the year 1917; for the petitioner's books of account were kept on a mixed basis, some accounts being accrued and some containing only actual receipt and disbursement items, and in the petitioner's books of account the petitioner's munitions manufacturers' tax was entered only on an actual disbursement basis. There was no entry with reference to the petitioner's munitions manufacturers' tax on its books during the year 1916. The first and only entry with reference to the petitioner's munitions manufacturers' tax was made in July, 1917, when the tax was paid. The petitioner's earnings statement for the year 1916, made out according to the accounts on its books, did not reflect the accrual or the payment of the munitions manufacturers' tax, and if the petitioner had made its income tax return for the year 1916 so that its income statement thereon jibed precisely with the income statement from its books, the munitions manufacturers' tax would not have been used as a deduction in 1916.

In the consideration of the foregoing point it should be remembered that Section 13 (d) of the Revenue Act of 1916 makes no use of the words "accrue" or "accrual" but merely permits a corporation to make its income tax returns on the basis on which its accounts are kept (See 269 U. S. 422, 441), and that in both of the two cases decided by this Court the corporation's accounts were so kept that the munitions manufacturers' tax was accrued on the corporation's books, while in the case at issue the petitioner's accounts were so kept that the petitioner's munitions manufacturers' tax was not accrued on the petitioner's books.

If it be argued by the respondent that the fact that the petitioner contested the munitions manufacturers' tax, as

applied to its products, may have been a reason why the tax was not accrued on the petitioner's books, a conclusive answer is that that fact would be a sufficient reason why the tax should not be accrued and why it should not be deducted in 1916.

If it be claimed that the mixed basis upon which the petitioner kept its books did not reflect true net income, then the Commissioner of Internal Revenue had but one alternative under the income tax law of 1916 and the rulings and regulations promulgated by the Treasury Department thereunder, and that was to correct the petitioner's income tax returns on an actual receipt and disbursement basis.

Treasury Decision 2433, Record, p. 141;

American Can Co. vs. United States, 31 Fed. Rep. (2nd) 730, (C. C. A., 3d Circ.).

In this case the Court said (p. 731):

"Since the basis used by the plaintiffs did not reflect their true income, to what basis could the Commissioner legally change? Section 13 (d) of title I of the Revenue Act of 1916, 39 Stat. 771, provides that:

"'(d) A corporation, joint-stock company or association, or insurance company, keeping accounts upon any basis other than that of actual receipts and disbursements, unless such other basis does not clearly reflect its income, may, subject to regulations made by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, make its return upon the basis upon which its accounts are kept, in which case the tax shall be computed upon its income as so returned.'

"Accordingly, if a corporation has kept its accounts upon a basis other than that of 'actual receipts and disbursements,' it may, subject to regulations of the Commissioner, with the approval of the Secretary of the Treasury, make its return upon that basis, and the tax on its income shall be computed as so returned,

if it clearly reflects its income; but, if it does not clearly reflect its income, then the tax must be computed on the cash, or receipts and disbursements, basis as prescribed in section 12, which provides that:

(Portions of Section 12 quoted)

"This is the receipts and disbursements, or cash, basis, and the tax must be assessed on this basis. (Citing authorities.)

"In the Act of 1918 (40 Stat. 1057, *et seq.*) Congress expressly conferred upon the Commissioner power to redetermine the income on such basis as he might prescribe; but he had no such power under prior acts, and, if the accrual or other basis used by the taxpayer in making his return did not reflect the true net income, he must use the cash basis.

"As the basis which the Commissioner used in redetermining the tax was not authorized in the Act of 1916, it was contrary to law, as found by the District Court. The tax which the District Court ordered refunded was the excess which the plaintiffs paid, computed on the receipts and disbursements basis, and was right in law and fact."

It will be noted that the foregoing decision of the Circuit Court of Appeals for the Third Circuit is in conflict with the decision of the Circuit Court of Appeals for the Sixth Circuit in the case at issue. In the case in the Third Circuit, the Circuit Court of Appeals held that under the Internal Revenue Law of 1916 the Commissioner of Internal Revenue could correct the taxpayer's income tax return *only on a receipt and disbursement basis,* even though the return was intended to be, in general, an accrual return, while in the case at issue, the Circuit Court of Appeals held that under the Internal Revenue Law of 1916 the Commissioner of Internal Revenue could correct the taxpayer's income tax return on an accrual basis even though the return was intended to be and was, at least in the main, an actual receipt and disbursement return.

The precise question involved in the American Can Company cases, to-wit, whether an arbitrary inventory write-up, overstating the inventory cost, constitutes a basis of keeping accounts, is, of course, not involved in the case at issue, and the decision of the Circuit Court of Appeals for the Second Circuit in the case of *American Can Company vs. Bowers, Collector,* hereinabove cited, that the inventory write-up involves merely an error in valuation figures and does not involve a basis of keeping accounts, is not contrary to the general principle laid down by the Circuit Court of Appeals for the Third Circuit and hereinbefore set forth, nor to the petitioner's contentions in the case at issue, but, on the contrary, presupposes and recognizes the general principle hereinbefore set forth. The exact *ratio decidendi* of the Circuit Court of Appeals for the Second Circuit is set forth in the following sentence:

> "The determination of the value to be placed upon an inventory has no relation to the principle or theory affecting the determination of when income is deemed to be received and when expenses are deemed to be incurred."

To say, as the respondent must, to succeed in the case at issue, that a corporation which has made its income tax return not only on a basis recognized under the then regulations and rulings of the Commissioner of Internal Revenue as an actual receipt and disbursement return, but in a form then required by the Commissioner of Internal Revenue for an actual receipt and disbursement return, and which, in its income tax return, has expressly declared the return to be an actual receipt and disbursement return, and which has made out its return on a basis different from the basis on which its accounts are kept,—to say that such corporation has elected to make an income tax return on an "accrual" basis or on the basis on which its accounts are kept, is, we submit, not only shockingly unjust but logically unthinkable.

It may be added that the petitioner's amended income tax return for the year 1916 was made out by the petitioner's secretary and auditor in collaboration with an auditor from the Internal Revenue Department, who, at the same time, made out the petitioner's munitions manufacturers' tax return for the year 1916, and audited both returns; that the income tax return so made out, audited and approved by the Internal Revenue Department, was indisputably made out in every respect on an actual receipt and disbursement basis, subject to the disputed questions as to the use of inventories and the treatment of bills and accounts receivable and payable as cash receipts and disbursements, and that the return so made out, audited and approved by the Internal Revenue Department's representative was palpably and indisputably very erroneous if made on an accrual basis. It should further be noted that the Internal Revenue Department has still left the petitioner's 1916 income tax return made out on the same actual receipt and disbursement basis as that on which it was made out by the government auditor in conjunction with the petitioner's representatives, except as to the one item of the munitions manfacturers' tax. For example, the Internal Revenue Department has not allowed a deduction in the petitioner's 1916 income tax return of the sum of $108,006.55, Federal income tax accrued for the year 1916,* together with certain other accrued taxes and large reserves, for the reason that the petitioner's 1916 income tax return *was* an actual receipt and disbursement return, and has deducted in the year 1916 a munitions tax alleged to have accrued in that year on the ground that the petitioner's 1916 income tax return *was not* an actual receipt and disbursement return but was a return made on the

*NOTE: 1916 income taxes deducted on an accrual basis would be deductible from 1916 income, but, since income taxes were made non-deductible in 1917, 1916 income taxes deducted on an actual disbursement basis would never be deductible.

"accrual" basis. Certainly the courts should redress such indefensible injustice.

As hereinabove indicated, the decisions of the courts below in the case at issue have been due to their belief that the decision of this Court in the case of *United States vs. Anderson* compels a like decision in the case at issue, and, as hereinabove indicated, we respectfully submit that the lower courts are in error in such belief.

The decision in the *Anderson* case was expressly put upon the ground that the record in that case failed affirmatively to show either that the company's books were kept *or* that the company's tax returns were made on the basis of actual receipts and disbursements. (See 269 U. S. 422, 433.) In the case at issue all of the facts bearing on the questions on what basis the petitioner's accounts were kept and, more particularly, on what basis its income tax returns were made, are before this Court, and it is clearly shown that the accounts in the petitioner's books were on a mixed basis but that the petitioner's income tax returns were made on an actual receipt and disbursement basis in every particular, subject to the controverted questions as to the effect of the use of inventories and the treatment of ordinary bills and accounts receivable and payable as cash receipts and disbursements.

Moreover, some of the differences, at least, between the facts in the *Anderson* case and the facts in the case at issue are shown by the records. In the *Anderson* case, large reserves, accrued on the books of the company, were used as deductions from gross income in making out the tax return. In the case at issue, such reserves, amounting to large sums of money, set up on the petitioner's books in the year 1916, were not used as deductions in making out the petitioner's tax returns. In the *Anderson* case, all income and expenditure items seem to have been reported on the accrual basis except the item of taxes. In the case at issue, the in-

come tax returns were actual receipt and disbursement returns in every respect, subject to the disputed questions as to the effect of the use of inventories and the treatment of ordinary bills and accounts receivable and payable as cash receipts and disbursements. In the *Anderson* case, there was no declaration of the taxpayer as to the basis on which it made its income tax returns. In the case at issue, the petitioner expressly declared in its income tax returns that it made the returns on the basis of actual receipts and disbursements.

In the *Anderson* case the taxpayer set up reserves for and accrued its munitions manufacturers' tax on its books, while in the case at issue, the petitioner's munitions manufacturers' tax was never accrued on its books nor were any reserves ever set up against said tax.

VII.

IN CONCLUSION.

In conclusion, we may sum up as follows:

Under the provisions of the United States Internal Revenue Act of 1916 and under the proper construction of the decisions and opinion of this Court in the cases of *United States vs. Anderson* and *United States vs. Yale and Towne Manufacturing Company,* hereinabove cited, a corporation was obliged to make its income tax returns for the years 1916 and 1917 on an actual receipt and disbursement basis, as then defined by the Commissioner of Internal Revenue, unless the corporation kept its accounts upon a basis other than that of actual receipts and disbursements, *and* unless the corporation elected to make its income tax returns upon the basis upon which its accounts were kept.

The petitioner's income tax returns for the years 1916 and 1917 were made on the basis of actual receipts and

disbursements, as then defined by the regulations and rulings of the Commissioner of Internal Revenue, and in exact conformity with the Commissioner's regulations and rulings then governing actual receipt and disbursement returns, and were expressly stated to be actual receipt and disbursement returns; and thereunder the petitioner's taxes could be deducted only in the year when actually paid.

The petitioner never exercised its option to avail itself of the provisions of Section 13 (d) of the Revenue Act of 1916, granting it the privilege of making its income tax returns on the basis on which its accounts were kept, as is conclusively proved, not only by the direct testimony of the petitioner's Secretary but by the following incontrovertible and decisive facts:

(a) The petitioner kept its books of account and made its income tax returns after the passage of the Revenue Act of 1916, containing Section 13 (d), in exactly the same way as it had previously done under the Revenue Act of 1913, proving that no action under Section 13(d) of the 1916 Act was ever taken by the petitioner.

(b) The petitioner's books of account were kept on a mixed basis, there being both cash receipt and disbursement accounts and accrued and reserve accounts on the petitioner's books, whereas the petitioner's income tax returns for the years 1916 and 1917 figured the petitioner's income very differently from the income shown on the petitioner's books of account, in that the accruals and reserves, amounting to large sums of money, set up on the petitioner's books of account, were eliminated in making out the petitioner's income tax returns, and the tax returns were made showing actual cash receipts and disbursements, subject to the use of inventories and the treat-

ment of bills and accounts receivable and payable growing out of its manufacturing operations as cash receipts and disbursements.

(c) The petitioner expressly said in its income tax returns for the years 1916 and 1917 that these returns were made on the actual receipt and disbursement basis.

Even if we assume that it was improper for the petitioner in an actual receipt and disbursement return to use inventories in figuring its gross income from operations, and to treat bills and accounts receivable and payable, arising out of its manufacturing operations, as cash receipts and disbursements on the dates when they were entered on its books, and that the petitioner should have disobeyed the regulations and rulings of the Treasury Department, obliging such use of inventories and such treatment of bills and accounts receivable and payable, yet the income tax returns, having been avowedly made on the actual receipt and disbursement basis, and having been made in exact conformity with the regulations and rulings of the Treasury Department then governing actual receipt and disbursement returns, and in full compliance with the form of corporation income tax return which the Treasury Department supplied and required to be used by the petitioner, the only correction, if any, that the Commissioner of Internal Revenue could properly have made, if the Treasury Department had subsequently changed its regulations and rulings governing actual receipt and disbursement returns, was to correct the income tax returns on the basis on which they were intended to be made, to wit, the actual receipt and disbursement basis.

Even if we assume that the petitioner had elected to make its income tax returns for the years 1916 and 1917 on the same basis on which its accounts were kept, the

munitions manufacturers' tax would not have been deducted in the year 1916 but in the year 1917, for the petitioner's accounts were kept on such basis that the petitioner's munitions manufacturers' tax account was entered on its books only on an actual disbursement basis and not on an accrual basis.

If it be claimed that the mixed basis upon which the petitioner kept its books did not reflect true net income, then the Commissioner of Internal Revenue had but one alternative under the income tax law of 1916 and the rulings and regulations promulgated by the Commissioner of Internal Revenue thereunder, and that was to correct the income tax returns on an actual receipt and disbursement basis.

The decision of this Court in the case of *United States vs. Anderson,* 269 U. S. 422, does not control the decision in the case at issue for at least three reasons.

In the first place, the record before this Court in the *Anderson* case did not affirmatively show that the taxpayer's income tax return was made on the basis of actual receipts and disbursements, but on the contrary apparently indicated that the return reported all items on the accrual basis except the item of taxes; whereas in the case at issue the petitioner's income tax returns for 1916 and 1917 were indisputably made on an actual receipt and disbursement basis in every particular, subject to the controverted questions as to the effect of the use of inventories and the treatment of ordinary bills and accounts receivable and payable as cash receipts and disbursements. For example, the record in the *Anderson* case showed that large reserves had been deducted in figuring income in the taxpayer's income tax return, while in the case at issue the record shows that large reserves set up on the petitioner's books of account were not deducted in figuring the petitioner's income in its income tax returns.

In the second place, in the *Anderson* case there was no declaration of the taxpayer as to the basis on which it made its income tax returns, whereas in the case at issue the petitioner expressly declared in its income tax returns that it made the returns on the basis of actual receipts and disbursements.

In the third place, in the *Anderson* case a reserve for the munitions manufacturers' tax was set up on the taxpayer's books in the year 1916, and an income tax return for the year 1916, made on the basis on which the taxpayer's accounts were kept, would contain a deduction of a munitions manufacturers' tax accrual; whereas in the case at issue, the petitioner's munitions manufacturers' tax (as well as the items in some other accounts) was not accrued on the petitioner's books, nor were any reserves ever set up against said tax, so that an income tax return for the year 1916, made on the mixed basis on which the petitioner's accounts were kept, would *not* contain any deduction of an accrued munitions manufacturers' tax.

The decision in the *Anderson* case, under the facts as found by this Court on the record in that case, is entirely in accord with the principles of law for which the petitioner herein contends, and the opinion of this Court in the *Anderson* case, with the exception of the two clauses of *obiter dicta* hereinabove discussed, lays down the principles of law for which the petitioner herein contends.

The great injustice to the petitioner of the decisions of the lower courts in this case, is manifest; for the petitioner, having religiously complied with the rules and regulations of the Treasury Department of the United States, governing actual receipt and disbursement returns, finds itself mulcted years afterward in the sum of $166,910.01 (besides the sum involved in a similar suit brought by the petitioner and now pending in the Court of Claims) on the basis of a repudiation, for the purposes of this case, of such

Treasury Department rules and regulations, by obedience to which the petitioner is alleged to have made a return on a basis never intended,—a basis not applied by the respondent except as to the one item of the munitions manufacturers' tax deduction, where it worked so harshly to petitioner's detriment.

WHEREFORE, it is respectfully submitted that the judgments of the Circuit Court of Appeals and of the District Court in this cause rendered should be reversed and that this case should be remanded to the United States District Court for the Northern District of Ohio, Eastern Division, with directions to enter judgment in this cause in favor of the petitioner for One Hundred and Sixty-six Thousand Nine Hundred and Ten Dollars and One Cent ($166,910.01), together with interest thereon from July 14, 1923, at the rate of six per cent (6%) per annum.

JOHN T. SCOTT,

Counsel for Petitioner.

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No. 7

In the Supreme Court of the United States

OCTOBER TERM, 1929

THE ALUMINUM CASTINGS COMPANY, PETITIONER

v.

CARL F. ROUTZAHN, INDIVIDUALLY AND AS COLLECTOR OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT

U. S. GOVERNMENT PRINTING OFFICE: 1929

In the Supreme Court of the United States

OCTOBER TERM, 1929

No. 198

THE ALUMINUM CASTINGS COMPANY, PETITIONER

v.

CARL F. ROUTZAHN, INDIVIDUALLY AND AS COLLECTOR of Internal Revenue

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT

The respondent does not oppose the petition.

One of the material questions involved in this case is whether the Commissioner of Internal Revenue has authority to correct a return on the accrual basis filed under Section 13 (d) of the Revenue Act of 1916, c. 463, 39 Stat. 756, 771.

The same question is involved in the case of *American Can Co.* v. *United States,* 31 F. (2d) 730, decided by the Circuit Court of Appeals for the Third Circuit, and now pending before this Court on the petition of the Government for a writ of certiorari (No. 128). In its petition for certiorari in that case (pages 7, 19) the Government has

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assigned as one of the reasons why the writ should be granted, the same conflict of decisions which petitioner now urges (Pet. 6, 40) as a reason for the granting of its petition.

In the *American Can Co. case*, construing Section 13 (d), *supra*, it was held that the action of the Commissioner in correcting taxpayer's inventories of tin plate to conform to the requirements of his regulations amounted to a rejection of the basis on which its books of account were kept and its return filed, and that since taxpayer's return, made in accordance with its method of valuing its tin plate on its books of account, did not reflect true income, the Commissioner had no alternative than to compute the income on the cash receipts and disbursements basis under Section 12 of the Revenue Act of 1916.

Petitioner in the instant case contends that since it adopted the method of treating its munitions tax account on its books on the cash receipts and disbursements basis and not on the accrual basis, and had otherwise not consistently followed the accrual system in keeping its books of account, the decision of the Circuit Court of Appeals, in approving the action of the Commissioner in correcting its returns for the years 1916 and 1917 to the extent of disallowing for the year 1917 a deduction of munitions taxes paid in that year and in allowing the deduction in the year 1916, the year said munitions tax accrued, is in conflict with the *American Can Co.*

case. Petitioner further contends, in reliance on that case, that if the mixed basis upon which petitioner kept its books of account did not reflect its true income, the Commissioner of Internal Revenue had but one alternative under the Revenue Act of 1916 and the rulings and regulations promulgated thereunder, and that was to correct the petitioner's income-tax returns on an actual receipt and disbursement basis. (Pet. 38–40.)

While we believe the decision of the Circuit Court of Appeals in the instant case is correct, we do not oppose the petition in view of the conflict between this case and the *American Can Co. case.*

Respectfully submitted.

CHARLES E. HUGHES, JR.,
Solicitor General.
SEWALL KEY,
MILLAR E. MCGILCHRIST,
Special Assistants to the Attorney General.

AUGUST, 1929.

○

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In the Supreme Court of the United States

OCTOBER TERM, 1929

THE ALUMINUM CASTINGS COMPANY, PETITIONER

v.

CARL F. ROUTZAHN, INDIVIDUALLY AND AS COLLECTOR OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR RESPONDENT

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In the Supreme Court of the United States

OCTOBER TERM, 1929

No. 198

THE ALUMINUM CASTINGS COMPANY, PETITIONER

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CARL F. ROUTZAHN, INDIVIDUALLY AND AS COLLECTOR of Internal Revenue

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BRIEF FOR RESPONDENT

OPINIONS BELOW

The opinion of the United States District Court for the Northern District of Ohio (R. 9–15) is reported in 24 F. (2d) 230. The opinion of the United States Circuit Court of Appeals (R. 151–155) is reported in 31 F. (2d) 669.

JURISDICTION

The judgment of the United States Circuit Court of Appeals (R. 151) was entered on April

2, 1929 (R. 151). Petition for certiorari to review the judgment was filed June 26, 1929, and was granted by this Court on October 21, 1929. (R. 155–156.) The jurisdiction of this Court rests on Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Was the Commissioner correct in refusing to allow the munition manufacturer's tax of the petitioner for the year 1916 as a deduction from gross income for the year 1917, when the tax was paid? This depends upon whether or not petitioner kept its books and made its return on the accrual basis.

STATUTE INVOLVED

The pertinent portions of the Revenue Act of 1916, c. 463, 39 Stat. 756, 767, 770, 771, read:

> SEC. 12. (a) In the case of a corporation, joint-stock company or association, or insurance company, organized in the United States, such net income shall be ascertained by deducting from the gross amount of its income received within the year from all sources—
>
> First. All the ordinary and necessary expenses paid within the year in the maintenance and operation of its business and properties * * *.
>
> * * * * *

SEC. 13. (a) The tax shall be computed upon the net income, as thus ascertained, received within each preceding calendar year ending December thirty-first:

* * * * *

(d) A corporation, joint-stock company or association, or insurance company, keeping accounts upon any basis other than that of actual receipts and disbursements, unless such other basis does not clearly reflect its income, may, subject to regulations made by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, make its return upon the basis upon which its accounts are kept, in which case the tax shall be computed upon its income as so returned;

* * * * *

STATEMENT

During 1916 and 1917 petitioner manufactured aluminum, brass and bronze castings, including munitions of war. The profits from the sale of such articles were subject to the munitions tax under Title III of the Revenue Act of 1916, c. 463, 39 Stat. 756, 780. During the year 1916 petitioner realized substantial profits upon the sales of such articles and the munitions tax for 1916 amounted to the sum of $246,275.63, which tax was paid by the petitioner in 1917.

Petitioner deducted the amount so paid from gross income for the year 1917 in determining the

amount of net income subject to income and excess profits taxes. (R. 24.) Petitioner stated on the tax return filed for 1917 that it was filed upon the cash receipts and disbursements basis, except that "bills and accounts payable and receivable are treated as receipts and disbursements." (R. 31, 34; Pet. Exhibit 3, R. 98.) The 1916 return was filed on the same basis, that is, " bills and accounts payable and receivable being entered as cash" (R. 35), although it was stated in the return filed for that year that the cash basis was used. (Pet. Exhibit 1, R. 81.) Upon a reaudit of the returns filed for the years 1916 and 1917, the Commissioner of Internal Revenue disallowed the deduction of the munitions tax in the sum of $246,275.63 from the gross income of petitioner for the year 1917, transferred it to the year 1916, and allowed it as a deduction from gross income for that year. (R. 24, 29.) This adjustment resulted in an additional tax for the year 1917 in the net sum of $148,364.45 (R. 25, 30), which sum, together with interest, is the amount sought to be recovered in this suit.

The District Court held that petitioner's books of account for the years 1916 and 1917 were kept on an accrual basis and its income returns for those years were made on the accrual basis, and that its munitions tax on profits earned in 1916 was deductible from its income for that year and not from its income for 1917. (R. 11.) Judgment was accordingly entered for respondent. (R. 26.)

The Circuit Court of Appeals for the Sixth Circuit affirmed the judgment of the District Court. (R. 151.)

SUMMARY OF ARGUMENT

Under the rule announced by this Court in *United States* v. *Anderson,* 269 U. S. 422, munitions taxes payable under Title III of the Revenue Act of 1916, on account of profits realized during 1916, accrued in that year. If the income tax return for that year is filed on an accrual basis, the sum payable as munitions taxes is deductible from gross income for 1916 and not 1917, for the purpose of computing the net income subject to income taxes. The petitioner's books of account were kept, and its tax returns were filed, on the accrual basis.

Notwithstanding the option given taxpayers to report on the accrual basis, the underlying purpose of the Act is to require returns that clearly reflect taxable income. In order to effectuate such a purpose it is necessary that the Commissioner have power to make corrections in all returns, irrespective of the basis upon which they are made. Such authority has been assumed without discussion by this Court, the Court of Claims, and others.

ARGUMENT

I

This Court decided in *United States* v. *Anderson,* 269 U. S. 422, that munitions taxes, assessable and payable under Title III of the Revenue Act of 1916

on account of net profits realized from the sale of munitions of war during the year 1916, accrued in that year, and that if the taxpayer's books were kept and its tax return for 1916 was filed on an accrual basis the munitions taxes were deductible from gross income for 1916, when accrued, and not in 1917, when due and payable. The rule announced in that case limits the scope of the controversy herein to the questions whether or not petitioner's books of account were in fact kept on the accrual basis, and whether its returns were actually filed on the accrual basis. If they were, we submit that this Court's decision in the *Anderson case* is controlling.

A trial by jury having been waived in writing (R. 7), the District Court made special findings of fact and conclusions of law. The findings of fact specifically state that petitioner, during the years 1916 and 1917, "kept its accounts upon a basis other than that of actual receipts and disbursements, commonly known as an accrual basis," and also that petitioner's tax returns for those years "were made, returned and filed on the basis on which its accounts were kept as aforesaid, viz., an accrual basis." (R. 25–26.) The Circuit Court of Appeals so held. (R. 155.)

These conclusions are supported by the evidence.

Testimony of petitioner's witness Watson, who made out petitioner's tax returns (R. 31), shows that for the years 1916 and 1917 petitioner had

accrued on its books bills receivable, accounts receivable, bills payable, accounts payable (R. 31, 35, 36), accrued taxes (R. 32, 36) other than accrued munitions taxes (R. 32), items of sales invoiced to purchasers before the money was received (R. 34), reserves for losses on doubtful accounts (R. 36), unpaid labor comprising both unpaid and unclaimed wages (R. 36), and reserves set up to take care of future possible expenditures and present unliquidated liabilities, such as reserves for commissions, for liability insurance, for fire insurance, for legal expenses, for high-priced metal, for Federal income taxes, for open receiving slips, and for unadjusted claims. (R. 36.)

Petitioner's witness Basler, an accountant who was in complete charge of its books of account during the years 1916 and 1917, and who assisted in the preparation of its tax returns for those years, testified that there were accrued on petitioner's books accounts payable, accounts receivable (R. 39–40), reserves for depreciation (R. 41), and prepaid expenses (R. 41).

Respondent's witness Dewey, a certified public accountant, who, while an Internal Revenue Agent, examined petitioner's books of account for the years in question, testified that petitioner's books were kept on the accrual basis because it used accounts receivable and payable and accrued various items on its books as representing a liability that had not yet been paid in cash but were to be paid in the future, having been incurred but not paid; that

he applied that rule to the bills and accounts payable as well as to items of insurance and taxes; that on the cash basis accounts receivable and payable are not taken into consideration but only the money actually received, that is, if a sale is made but the money is not then received, no entries are made on the books until the money is received (R. 42); and that his examination convinced him that the books were kept on the accrual basis (R. 45).

Respondent's witness Cohen, a certified public accountant and Internal Revenue Agent, testified that he examined petitioner's books for the years 1916 and 1917 for the purpose of determining on which basis of accounting they were kept; that his "conclusion was that they were kept on the accrual basis"; that he "examined the income tax returns and excess-profits tax returns for the years 1916 and 1917, filed by this Company" and "they appeared to be filed on the accrual basis"; that his conclusion was based on the facts that petitioner accrued on its books items of expense, and carried deferred charges as assets; that its tax returns appeared to be filed on the accrual basis because it took into consideration accounts receivable and accounts payable as cash items; that petitioner's balance sheets contained items indicative of the accrual system of keeping books, such as prepaid expenses, accounts receivable, reserves for doubtful accounts, notes receivable, accounts payable, unpaid labor, and reserves for accrued liabilities such as reserves for commissions, accrued taxes and legal expenses. (R. 46–47.)

Petitioner contends that its return of income for 1916 was not made on the accrual basis but on the "statutory" cash receipts and disbursements basis, as prescribed by previous regulations.

It is true that on September 14, 1916, the Commissioner of Internal Revenue instructed the collectors as follows (R. 134):

> Pending the adoption and promulgation of special regulations under the Act of September 8, 1916, Income Tax Regulations in Force September 8, 1916, are hereby extended and made applicable to the Act of September 8, 1916, so far as not inconsistent with the provisions of that statute.

On the strength of this ruling petitioner contends that it was permitted to file its return for 1916 on the same type and character of cash receipts and disbursements basis which had been required under the 1913 Act. The flaw in the argument of the petitioner is in assuming that such a return therefore constituted a return upon the basis of actual receipts and disbursements. This is demonstrated by the opinion of this Court in *United States* v. *Anderson, supra,* in which this Court said (269 U. S., at 440):

> A consideration of the difficulties involved in the preparation of an income account on a strict basis of receipts and disbursements for a business of any complexity, which had been experienced in the application of the Acts of 1909 and 1913 and which made it

necessary to authorize, by departmental regulation, a method of preparing returns not in terms provided for by those statutes, indicates with no uncertainty the purpose of Sections 12 (a) and 13 (d) of the Act of 1916. It was to enable taxpayers to keep their books and make their returns according to scientific accounting principles, by charging against income earned during the taxable period, the expenses incurred in and properly attributable to the process of earning income during that period; and indeed, to require the tax return to be made on that basis, if the taxpayer failed or was unable to make the return on a strict receipts and disbursements basis.

The appellee's true income for the year 1916 could not have been determined without deducting from its gross income for the year the total cost and expenses attributable to the production of that income during the year. The reserve for munitions taxes set up on its books for 1916 must have been deducted from receivables for munitions sold in that year before the net results of the operations for the year could be ascertained. The taxpayer being unable to make its return on a strict receipts and disbursements basis, and not having attempted to do so, could not have complied with Section 13 (d) and Treasury Decision 2433 by deducting either accruals of interest or expenses alone without the other, or without deducting other reserves made on its books to meet liabilities

> such as the munitions tax, incurred in the process of creating income.

The petitioner contends that it designated its return as made upon the cash receipts and disbursements basis. That fact, of course, is not controlling. The return was not made upon a strict receipts and disbursements basis. Whether the taxpayer could have made a return on such a basis we need not consider. The District Court said that it is probable that it could not have made a return on that basis, by which we assume that it meant that it could not have made a return on that basis which would have reflected its true income on account of the nature of its business, its manner of keeping its accounts, and the basis upon which its previous returns had been prepared. It is quite possible that it would not have been permitted by the Commissioner to compute its income on a strict receipts and disbursements basis, but that question is not involved in the instant case. The legislative history of the Act indicates that Section 13 (d) referred to only two kinds of returns, based upon the two fundamental systems of accounting, and permitted the selection only of that basis which would clearly reflect income. The report of the Ways and Means Committee of the House (H. Rept. No. 922, 64th Congress, First Session, p. 4), respecting the enactment of Section 13 (d) said:

> As two systems of bookkeeping are in use in the United States, one based on the cash or receipt basis and the other on the accrual basis, it was deemed advisable to provide in

> the proposed measure that an individual or corporation may make return of income on either the cash or accrual basis, if the basis selected clearly reflects the income.

In view of the fact that petitioner failed to make its return on the "strict receipts and disbursements basis," we submit that it was *required* to file its return on the accrual basis.

The District Court disposed of petitioner's contentions in the following language (R. 14–15):

> Plaintiff's income return conforms to its books as thus kept, with certain limited exceptions. It did not deduct in its return the full reserve of $108,006.55 set up for federal income tax, but only the amount of taxes actually paid during the year 1916. It did not deduct all of the other amounts set up as reserves. It may even be conceded that the other reserves were disregarded, except so far as actually used or necessary to discharge liabilities actually paid during 1916, or the amount of which was definitely ascertained. The fact remains, however, that plaintiff's books were kept and plaintiff's return was made substantially upon an accrual basis. It is probable that plaintiff could not have made an income return on a strict basis of actual receipts and disbursements. Section 13 (d), as was said in the Anderson case, was enacted to meet this situation. Its effect is to compel a departure from the practice followed prior to 1916, whenever the taxpayer keeps his books or attempts to make his return otherwise than on a strict basis of re-

ceipts and disbursements, or when he is not able to make it in that way. An election results from what is done, notwithstanding the taxpayer may disclaim any such intention.

As I understand the facts of the Anderson case, they were not substantially different from the facts of this case. The difference most strongly stressed is that in the Anderson case, a reserve, beginning with September, 1916, was in fact set up to take care of the munitions tax, whereas in this case none was set up, owing probably to the plaintiff's belief that its product was not subject to the munitions tax. But in the Anderson case that reserve was closed out by entry made December 31, 1916. A distinction can not be based upon an entry thus made and later corrected, and a mere failure to make any entry at all. The controlling facts of the two cases are the same.

The Circuit Court of Appeals in the instant case said (R. 154–155):

> It is objected that prior to 1916 no other basis for return was recognized than that upon cash receipt and disbursement basis; that the internal revenue regulations then definitely recognized and established that differences in inventory value, accounts receivable and payable created during the year, and depreciation, were proper items for inclusion in a return upon the cash receipt and disbursement basis and were recognized as cash items; that section 13 (d) did not vary this prior practice but, the regulations

and requirements of the Department remaining unchanged, simply gave to the taxpayer the option of making its return upon an accrual basis; that these items thus continued and remained proper "cash items" in a receipt and disbursement return unless the taxpayer had elected to make return upon some other basis; and that this plaintiff has definitely refused to so exercise such option. These contentions are likewise answered by the case of *United States* v. *Anderson, supra,* at pp. 439, 440. The difficulty if not the utter impossibility of preparing a return upon a strict basis of receipts and disbursements in most cases constituted at once the reason and necessity for the enactment of section 13 (d). The mere fact that by the prior law a return upon the basis of receipts and disbursements was alone recognized and required and the fact that, for reasons of necessity and expediency and in order that the return might truly reflect the income of the taxpayer, the department was driven to permit and require the use of accrual items in then making such returns, do not irrevocably classify such items as actual receipts and disbursements or preclude return to and application of correct definition when the machinery therefor is provided.

II

The Commissioner had full authority to correct tax returns filed on the accrual basis.

The question whether or not the correction by the Commissioner of income and profits tax returns filed on the accrual basis for the years 1916 and 1917 *ipso facto* requires the computation to be made on the cash receipts and disbursements basis was raised in the petition for certiorari. Since the same question is also involved in the cases of *United States* v. *American Can Company, et al.*, Nos. 128, 129 and 130, October Term, 1929, now pending before this Court on writs of certiorari, and is fully argued in the brief for the United States in those cases, it seems unnecessary to repeat the argument here. Copy of the brief in the *American Can Company cases* has been served on counsel for petitioner in the instant case.

In those cases the correction made by the Commissioner concerned the method adopted in keeping inventories. The correction made here involved a single item of tax liability which had not been taken into account by a taxpayer on the accrual basis. We submit that the theory that a correction by the Commissioner in a return on the accrual basis necessitates a return on the cash basis is unsound and needs no further argument here.

CONCLUSION

In view of the foregoing, it is respectfully submitted that the judgment of the court below is correct and should be affirmed.

CHARLES E. HUGHES, Jr.,
Solicitor General.
G. A. YOUNGQUIST,
Assistant Attorney General.
CLAUDE R. BRANCH,
SEWALL KEY,
J. LOUIS MONARCH,
S. DEE HANSON,
Special Assistants to the Attorney General.

JANUARY, 1930.

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No. 7

In the Supreme Court of the United States

OCTOBER TERM, 1930

THE ALUMINUM CASTINGS COMPANY, PETITIONER

v.

CARL F. ROUTZAHN, INDIVIDUALLY AND AS COLLECTOR OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE RESPONDENT ON REARGUMENT

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Reports of congressional committees:
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House Report No. 1037, 65th Cong., 3d sess., pp. 3, 44 ..... 18, 42–43
Miscellaneous:
Cumulative Bulletin No. 4, January-June, 1921, p. 147 20

In the Supreme Court of the United States

OCTOBER TERM, 1930

No. 7

THE ALUMINUM CASTINGS COMPANY, PETITIONER,

v.

CARL F. ROUTZAHN, INDIVIDUALLY AND AS COLLECTOR of Internal Revenue

ON WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE RESPONDENT ON REARGUMENT

OPINIONS BELOW

The opinion of the District Court for the Northern District of Ohio (R. 9–15) is reported in 24 F. (2d) 230. The opinion of the Circuit Court of Appeals (R. 151–155) is reported in 31 F. (2d) 669.

JURISDICTION

The judgment of the Circuit Court of Appeals (R. 151) was entered on April 2, 1929. The petition for certiorari was filed June 26, 1929 (R. 156), and was granted by this Court on October 21, 1929 (R. 155). The jurisdiction of this Court rests on

Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the Commissioner of Internal Revenue was correct in refusing to allow the munitions manufacturers' tax of the petitioner for the year 1916 as a deduction from gross income for the year 1917, when the tax was paid.

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved are set forth in the appendices, *infra,* pp. 25–41.

STATEMENT

During 1916 and 1917 the petitioner was engaged in the manufacture of aluminum, brass, and bronze castings, including munitions of war. The profits from the sale of such articles were subject to the munitions tax under Title III of the Revenue Act of 1916, c. 463, 39 Stat. 756, 780. (R. 24.) During the year 1916 the petitioner realized substantial profits upon the sales of these articles and the munitions tax for 1916 amounted to the sum of $246,275.63, which tax was paid by the petitioner in 1917. (R. 24.)

The petitioner deducted the amount so paid from its gross income for the year 1917 in determining the amount of net income subject to income and excess profits taxes in that year. (R. 24.) The petitioner stated on the tax return which it filed for 1917 that it was filed upon the cash receipts and

disbursements basis, except that "Bills and accounts payable and receivable are treated as receipts and disbursements." (R. 31, 34, 98.) The petitioner's return for 1916 had been filed on the same basis, "bills and accounts payable and receivable being entered as cash" (R. 35), although it was stated in the return filed for that year that the cash basis was used (R. 81). Upon a reaudit of the returns filed for the years 1916 and 1917, the Commissioner of Internal Revenue disallowed the deduction of the munitions tax in the sum of $246,275.63 from the gross income of the petitioner for the year 1917, transferred it to the year 1916, and allowed it as a deduction from gross income for that year. (R. 24, 29.) This adjustment resulted in an additional tax in the net sum of $175,053.29. (R. 25, 30.) The collector collected part of this, and the rest of the asserted liability was discharged by application of a credit. (R. 25.) Petitioner sued the collector to recover the amount paid him.

The case was tried before the District Court on written waiver of jury trial. (R. 7.) The District Court found as facts that the petitioner's books of account for the years 1916 and 1917 were kept on an accrual basis (R. 25–26), and that its income-tax returns for these years were made on the accrual basis (R. 25–26). It accordingly held that the munitions tax on profits earned in 1916 was deductible from gross income in that year and not from gross income for 1917. (R. 23.) Judgment for the respondent (R. 26) was affirmed by the Cir-

cuit Court of Appeals for the Sixth Circuit (R. 151).

SUMMARY OF ARGUMENT

I

If the petitioner's tax return for the year 1917 was made substantially upon the accrual basis, the munitions tax for the year 1916 can not be deducted in computing taxable income for 1917. There are two methods of accounting which can reflect income clearly—the "cash receipts and disbursements" method and the "accrual" method. This fact was understood by Congress at the time the Revenue Act of 1916 was passed.

In order that income be clearly reflected, when a return is made on the accrual basis all items, both of receipts and disbursements, must be consistently included when accrued, whether paid or received or not. This plain economic fact has been asserted by the administrative regulations of the Treasury Department, the validity of which has been recognized in the decisions of this Court.

If any item in the return was incorrectly entered and should not have been included in a return made on the accrual basis, the Commissioner was justified in correcting the return as to that item.

II

The petitioner's return for the year 1917 was substantially upon the accrual basis. This was found as a fact by the District Court, and the Circuit Court of Appeals agreed that this was correct.

The evidence clearly establishes this. The testimony shows that for the years 1916 and 1917 the petitioner had accrued on its books bills receivable, accounts receivable, bills payable, accounts payable, accrued taxes other than accrued munitions taxes, items of sales invoiced to purchasers before the money was received, reserves for losses on doubtful accounts, and various other reserves.

The petitioner contends that its returns for 1916 and 1917 were on a "statutory" cash basis, such as had been required under the 1913 Act. But the Revenue Act of 1916 differed from the earlier Revenue Acts so materially that the previous regulations were not applicable. And in any event the previous regulations were not continued in effect. The petitioner's argument on this point is substantially the same as that which was rejected by this Court in *United States* v. *Anderson,* 269 U. S. 422.

It is immaterial that the petitioner's return stated that it was made upon the cash receipts and disbursements basis. The evidence shows that the return was in fact made substantially upon the accrual basis, and this fact should be controlling.

III

Even if the petitioner was entitled to change its return to one on a strictly cash basis, it has not shown what its tax liability would be on such a return, and hence it can not recover.

ARGUMENT

I

IF THE PETITIONER'S RETURN FOR 1917 WAS MADE SUBSTANTIALLY UPON THE ACCRUAL BASIS, THE MUNITIONS TAX FOR THE YEAR 1916 CAN NOT BE DEDUCTED IN COMPUTING TAXABLE INCOME FOR 1917

The Revenue Act of 1916, c. 463, 39 Stat. 756, 771, was the first of the various income tax acts to recognize the fact that taxable income may be computed on more than one basis.[1] Section 13 (d) of that Act provided that—

> A corporation, joint-stock company or association, or insurance company, keeping accounts upon any basis other than that of actual receipts and disbursements, unless such other basis does not clearly reflect its income, may, subject to regulations made by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, make its return upon the basis upon which its accounts are kept, in which case the tax shall be computed upon its income as so returned; * * *.

The petitioner's position in this case seems to be based upon the contention that under the Revenue Act of 1916 a corporation may properly make a

[1] The earlier acts, in providing for the computation of income and of deductions, used such words as "received" and "paid." See sec. 38 of the Corporation Excise Tax Law of 1909, c. 6, 36 Stat. 11, 112–113 (*infra*, p. 25), and subdivision G (a) of the corporation income tax provisions of the Act of October 3, 1913, c. 16, 38 Stat. 114, 172–173 (*infra*, pp. 25–266).

return of income upon a hybrid basis, which is not based consistently upon either accruals or cash receipts and disbursements. We contend that this position is untenable.

Experience has shown that there are two bases of accounts which can reflect income properly, namely, the "cash receipts and disbursements" basis and the "accrual" basis. That this fact was understood by Congress at the time Section 13 (d) was enacted is shown by the report of the Committee on Ways and Means to the House (House Report No. 922, 64th Congress, 1st Sess., p. 4; *infra*, p. 42), respecting the enactment of the section, which stated:

> As two systems of bookkeeping are in use in the United States, one based on the cash or receipt basis and the other on the accrual basis, it was deemed advisable to provide in the proposed measure that an individual or corporation may make return of income on either the cash or accrued basis, if the basis selected clearly reflects the income.

In order that income may be clearly reflected, it is necessary where income is computed on the accrual basis that all items, both of receipts and disbursements, must be consistently included when accrued, whether paid or received or not. This plain economic fact has been asserted in the administrative regulations of the Treasury Department, the validity of which has been recognized in the decisions of this Court.

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On January 8, 1917, shortly after the enactment of the Revenue Act of 1916, and before the petitioner in this case made its return for the year 1916, the Treasury Department promulgated Treasury Decision 2433 (*infra,* pp. 38–41), which provided:

> This ruling contemplates that income and authorized deductions shall be computed and accounted for on the same basis. * * *

In Article 23 of Regulations 45, promulgated under the Revenue Act of 1918, this requirement is stated as follows:

> A method of accounting will not, however, be regarded as clearly reflecting income unless all items of gross income and all deductions are treated with reasonable consistency.

This regulation has been continued in force until the present without change. See Regulations 62 (1922 ed.), Article 23; Regulations 65 (1924), Article 23; Regulations 69 (1926), Article 23; Regulations 74 (1929), Article 322.

This Court has recognized the fact that if a return is on the accrual basis all items, both of receipts and disbursements, must be included as they accrue, if the return is to reflect income clearly. Thus, in *United States* v. *Anderson,* 269 U. S. 422, this Court said as to the purpose of Sections 12 (a) and 13 (d) of the Act of 1916 (p. 440):

> It was to enable taxpayers to keep their books and make their returns according to scientific accounting principles, by charging

> against income earned during the taxable period, the expenses incurred in and properly attributable to the process of earning income during that period; and indeed, to require the tax return to be made on that basis, if the taxpayer failed or was unable to make the return on a strict receipts and disbursements basis.
>
> The appellee's true income for the year 1916 could not have been determined without deducting from its gross income for the year the total cost and expenses attributable to the production of that income during the year. * * *

A similar statement is found in *United States* v. *Mitchell*, 271 U. S. 9, where it is said of the 1918 Act (pp. 12–13):

> Notwithstanding the option given taxpayers, it is the purpose of the Act to require returns that clearly reflect taxable income. That purpose will not be accomplished unless income received and deductible disbursements made are treated consistently. * * * It is a reasonable construction of the law that the same method be applied to both sides of the account.

Accordingly, it is our contention that if the petitioner's return for the year 1917 was made substantially on the accrual basis the munitions tax for the year 1916 must be treated on that basis, and can not be deducted when computing taxable income for the year 1917, in which it was in fact paid. It is, of course, beyond dispute that the

munitions taxes for the year 1916, the tax involved in this case, accrued in 1916. That question was expressly decided in *United States* v. *Anderson,* 269 U. S. 422.

If any item in the return was incorrectly entered and should not have been included in a return made upon the accrual basis, the Commissioner was justified in correcting the return as to that item. In its petition for certiorari the petitioner contended that the correction made by the Commissioner *ipso facto* required him to compute the entire tax on the cash receipts and disbursements basis. But this contention has since been disposed of by this Court in *United States* v. *American Can Co.,* 280 U. S. 412, 419, in which it was held that the correction of a single item in a return did not "constitute rejection of the basis upon which the return was constructed." A correction similar to the one involved in this case was sustained by this Court in *United States* v. *Anderson,* 269 U. S. 422. The *American Can case* and the *Anderson case* involved returns of taxes for the year 1917 and arose under the same Act as that here involved, the Revenue Act of 1916. In *Niles Bement Pond Co.* v. *United States,* 281 U. S. 357, 360, this Court said:

> Under the 1916 Act where the taxpayer's books are kept and his returns made on the accrual basis, taxes charged on the books as they accrue must be deducted when accrued, if true income is thus reflected. *United States* v. *Anderson,* 269 U. S. 422. *Even if*

> *not so charged,* it was competent for the Commissioner, under the Act of 1916, as well as under the express provisions of § 212 (b) of the Act of 1918, to correct the taxpayer's return by deducting the payments in the year in which they accrued so as to reflect true income by *conforming to the dominating or controlling character of the taxpayer's system of accounts.* (Italics ours.)

Petitioner argues that the action of the Commissioner unjustly operated to deprive it of the right to deduct Federal income taxes which accrued during 1916 but were not paid until 1917.[2] But the petitioner has not sought to have the correction made in its 1916 return. It would seem that if it had made timely application it would have been entitled to have these taxes deducted from its 1916 income. As this Court said of a similar situation in *Niles Bement Pond Co.* v. *United States,* 281 U. S. 357, 362, *supra:*

> If that assumption is made, failure of the Commissioner to correct the returns in these respects is as attributable to his error or oversight or lack of information as to any opinion on his part as to the propriety of the deductions in the years made.

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[2] Under the fourth paragraph of Section 12 (a) of the Revenue Act of 1916 "taxes paid within the year imposed by the authority of the United States" were deductible from gross income. Under Section 13 (b) of the 1916 Act the word "paid" would doubtless be read "paid or accrued." But by Section 1207 of the Act of October 3, 1917, c. 63, 40 Stat. 300, 334–335, this provision was amended so as to exclude the deduction of income and excess-profits taxes.

II

THE PETITIONER'S RETURN FOR THE YEAR 1917 WAS SUBSTANTIALLY UPON THE ACCRUAL BASIS

The District Court found as a fact that during the years 1916 and 1917 the petitioner (R. 25)—

> kept its accounts upon a basis other than that of actual receipts and disbursements, commonly known as an accrual basis.

It also found that the petitioner's tax returns for those years (R. 25–26)—

> were made, returned and filed on the basis on which its accounts were kept as aforesaid, viz., an accrual basis.

These conclusions were upheld by the Circuit Court of Appeals. (R. 155.) We do not rely wholly upon these findings. Apart from any effect which they may have as findings, we contend that the evidence clearly establishes that the findings were correct.

The testimony of the petitioner's witness Watson, who made out the petitioner's tax returns (R. 31), showed that for the years 1916 and 1917 the petitioner had accrued on its books bills receivable, accounts receivable, bills payable, accounts payable (R. 31, 35, 36), accrued taxes (R. 32, 36) other than accrued munitions taxes (R. 32),[3] items of sales

[3]Apparently the reason why the petitioner did not accrue munitions taxes on its books for the year 1916 was that it did not at the time regard itself as liable for these taxes. (Petitioner's Brief, pp. 34–35; R. 37.) The suggestion that these taxes did not accrue in 1916 because at the time liability for them was doubtful or contested is, we submit, without merit.

invoiced to purchasers before the money was received (R. 34), reserves for losses on doubtful accounts (R. 36), unpaid labor comprising both unpaid and unclaimed wages (R. 36), and reserves set up to take care of future possible expenditures and present unliquidated liabilities, such as reserves for commissions, for liability insurance, for fire insurance, for legal expenses, for high-priced metal, for Federal income taxes, for open receiving slips, and for unadjusted claims (R. 36).

The petitioner's witness Basler, an accountant who was in complete charge of its books of account during the years 1916 and 1917, and who assisted in the preparation of its tax returns for those years, testified that there were accrued on petitioner's books accounts payable, accounts receivable (R. 39–40), reserves for depreciation (R. 41), and prepaid expenses (R. 41).

Respondent's witness Dewey, a certified public accountant, who, while an Internal Revenue Agent, examined petitioner's books of account for the years in question, testified that petitioner's books were kept on the accrual basis, because it used accounts receivable and payable and accrued various items on its books as representing a liability that had not yet been paid in cash but were to be paid in the future, having been incurred but not paid; that he applied that rule to the bills and accounts payable as well as to items of insurance and taxes; that on

the cash basis accounts receivable and payable are not taken into consideration, but only the money actually received; that is, if a sale is made but the money is not then received, no entries are made on the books until the money is received (R. 42); and that his examination convinced him that the books were kept on the accrual basis (R. 45).

Respondent's witness, Cohen, a certified public accountant and Internal Revenue Agent, testified that he examined petitioner's books for the years 1916 and 1917 for the purpose of determining on which basis of accounting they were kept; that his "conclusion was that they were kept on the accrual basis"; that he "examined the income-tax returns and excess-profits tax returns for the years 1916 and 1917, filed by this Company" and "they appeared to be filed on the accrual basis"; that his conclusion was based on the facts that petitioner accrued on its books items of expense and carried deferred charges as assets; that its tax returns appeared to be filed on the accrual basis because they took into consideration accounts receivable and accounts payable as cash items; that petitioner's balance sheets contained items indicative of the accrual system of keeping books, such as prepaid expenses, accounts receivable, reserves for doubtful accounts, notes receivable, accounts payable, unpaid labor, and reserves for accrued liabilities such as reserves for commissions, accrued taxes, and legal expenses. (R. 46–47.)

In the light of the facts as established by this evidence we submit that the "dominating or controlling character of the taxpayer's system of accounts" and of its return was that of the accrual basis.[4] See *Niles Bement Pond Co.* v. *United States,* 281 U. S. 357, 360 (pp. 10–11, *supra*).

The petitioner contends that its return of income for 1916 was not made on the accrual basis but on the "statutory" cash receipts and disbursements basis, as prescribed by previous regulations. In examining this contention it will be necessary to discuss briefly the legislation and regulations which preceded the Revenue Act of 1916.

The Corporation Excise Tax Law of 1909, c. 6, 36 Stat. 11, 112–113 (*infra,* p. 25), and the corporation income tax provisions of the Act of October 3, 1913, c. 16, 38 Stat. 114, 172–173 (*infra*, pp. 25–26), made no express provision for returns upon

[4] The petitioner's gross income for 1917 was $18,696,446.73, of which $18,679,704.16 represented gross income from operations. The total deductions amounted to $17,283,304.91, of which $15,358,391.84 represented cost of goods and other property sold. (R. 87.) The item "Cost of Goods and Other Property Sold" was principally made up of $11,203,593.35, "Merchandise bought for sale." (R. 93.) Thus, the cost of raw materials and the sales price of the manufactured goods constituted the major items on petitioner's accounts. The cost of the raw material was entered on the books as Accounts Payable and the sales were entered on the books as Accounts Receivable. (R. 31, 34, 35.) These were accrual items, and not cash items: and it is apparent that the dominating and controlling character of petitioner's system of accounts was the accrual basis.

the accrual basis,[5] but the regulations issued under these Acts allowed many variations from a strict cash method of accounting. Articles 2, 4, and 6 of Regulations 31 (*infra,* pp. 31–33), promulgated under the Act of 1909, contained several provisions inconsistent with a strict cash basis in making returns. In Regulations 33, promulgated under the Act of October 3, 1913, Article 104 (*infra,* pp. 33–34), provided for the use of inventories, and Article 158 (*infra,* pp. 34–35) provided that—

> It is immaterial whether the deductions except for taxes and losses are evidenced by actual disbursements in cash, * * *.

But by Article 156 (*infra,* p. 34) of these regulations it was provided that taxes should be deducted only when actually paid, since that was the language of the Act allowing such deductions.[6]

The legislation of 1909 and 1913 and the regulations adopted under it showed that the subject was

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[5] But both Section 38 of the 1909 Act and Section G(b) of the 1913 Act allowed the deduction of depreciation, and the latter section allowed a deduction for depletion, items which would probably not be deductible in a strict cash receipts and disbursements system. This is simply another example of the formative stage of the law on this question at this period.

[6] As indicative of the formative stage of the practice at this period it should be noted that the Regulations under the 1909 and 1913 Acts made no sharp distinction between items "accrued" and items "received" or "paid," in the sense in which we now understand these terms. Thus, in Article 148 of Regulations 33 (*infra,* p. 34) it was provided that "The amount of interest *accrued and paid* within the year * * * constitutes an allowable deduction." (Italics ours.)

undeveloped, and that the resulting system was a mongrel one. The first explicit statutory recognition of the fact that the computation of income might depend upon the method of accounting used occurred in the Revenue Act of 1916, evidenced by the insertion of the new Section 13 (d), set out above (*supra*, p. 6).

The petitioner argues that the return filed was a proper return on the basis of cash receipts and disbursements under the 1909 and 1913 Acts, and that this return would have been a proper return under Section 12 (a) of the 1916 Act if Section 13 (d) had not been included in that Act. With this we have no dispute.[7] But the petitioner further contends that Section 13 (d) merely gave the taxpayer an option to file a return on another basis—an option which the taxpayer did not exercise—and that it had no effect upon the basis for making returns under Section 12 (a) if the taxpayer chose to continue to render returns on what had been a proper basis up to the time of the 1916 Act. But we submit that Section 13 (d) did not give the taxpayer an option to file a return on the mongrel basis which had been permitted under the regulations promulgated under earlier Acts.

Section 13 (d) was a stage in the introduction of approved accounting methods into the income

[7] The regulations, as construed in practice, treated accounts and bills receivable of a manufacturing corporation as income for the year in which they were created and allowed deductions of accounts payable when the liability was incurred. (R. 133.)

tax laws. The insertion of this section evidenced the recognition of Congress that the methods formerly required were not scientific, and did not clearly reflect income. See House Report No. 922, 64th Congress, 1st Session, p. 4; *supra,* p. 7.[8] We contend that after Congress had through Section 13 (d) given to taxpayers the option of filing a return on the accrual basis, no return could thereafter be filed as a cash return which was not in fact a cash return. After Section 13 (d) was enacted, the criterion by which a return was to be judged was whether it clearly reflected income, and we submit that a return in which accounts receivable are accrued, but taxes incurred in producing the receivables are not accrued, is not a return which clearly reflects income.

It is true that on September 14, 1916, shortly after the passage of the Revenue Act of 1916, the Commissioner of Internal Revenue issued Treasury Decision 2367 (*infra,* p. 38), which provided as follows:

> Pending the adoption and promulgation of special regulations under the act of September 8, 1916, income-tax regulations in force September 8, 1916, are hereby extended and made applicable to the act of September 8, 1916, so far as not inconsistent with the provisions of that statute.

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[8] The question was further clarified in the Revenue Act of 1918, c. 18, 40 Stat. 1057. See Sections 200, 212, and 213 of that Act, set out *infra,* pp. 28–29. See also House Report No. 1037, 65th Cong., 3d Sess., pp. 3, 44; *infra,* pp. 42–43.

Because of this ruling the petitioner contends that it was permitted to file its return for 1916 on the same basis which had been required under the 1913 Act. The flaw in this argument is the assumption that the kind of return which had been required under the 1913 Act, and the regulations promulgated thereunder, was in fact a return on the basis of cash receipts and disbursements. The mere fact that the petitioner made its returns for 1916 and 1917 on the same basis as its return for 1915 (R. 34) does not establish that its returns for 1916 and 1917 were made on the basis of cash receipts and disbursements.

In the first place the regulations in question were issued under an act which made no provision for returns on the accrual basis, while the Revenue Act of 1916, in Section 13 (d) (*supra,* p. 6), did contain such a provision. As this introduced a substantial change in the revenue laws, we submit that the provisions of the Revenue Act of 1916 were "inconsistent" with those of the 1913 Act, so that Treasury Decision 2367, *supra,* does not even in terms apply.

But in any event the Commissioner of Internal Revenue made specific provision for the situation now in question by a regulation issued under the Revenue Act of 1916, before the petitioner made its return for 1916 and more than a year before it made its return for the year in question. On January 8, 1917, the Treasury Department promul-

gated Treasury Decision 2433 [9] (*infra,* pp. 38–41), in which it was provided:

> This ruling contemplates that *the income and authorized deductions shall be computed and accounted for on the same basis* and that the same practice shall be consistently followed year after year. (Italics ours.)

The argument of the petitioner in this case seems to be essentially the same as that which was rejected by this Court in *United States* v. *Anderson,* 269 U. S. 422, where this Court said (pp. 438–439, 440):

> It was pressed upon us in argument by appellees that it was found impracticable to comply strictly with the requirements of the 1909 and 1913 Acts for computing income on the basis of receipts and disbursements and that under both acts the administrative practice was established, by appropriate Treasury regulations, permitting the use of inventories and authorizing deduction of expenses constituting a liability of the taxpayer, whether paid or not, in ascertaining net income, but that those regulations did not permit the deduction of taxes except in the year when paid. From this it is argued that Congress, by reenacting in § 12 (a) of

[9] This decision is discussed and followed in a long opinion of the Solicitor of Internal Revenue which appears in Cumulative Bulletin No. 4, January-June, 1921, p. 147. This opinion is referred to in *Niles Bement Pond Co.* v. *United States*, 281 U. S. 357, 359, and is copied in the Government's brief (pp. 47–60) in *United States* v. *Anderson,* No. 337, October Term, 1925.

the Act of 1916 the corresponding provisions of the earlier acts, adopted the settled administrative practice, and that accordingly under that act, as well as under the earlier acts and Treasury regulations, taxes could be deducted only in the year when paid.

This argument would have force had Congress stopped with the enactment of § 12(a). By thus adopting, without material change, the corresponding provisions of earlier acts, Congress might have been deemed to have recognized and adopted the established practice of the Department interpreting and applying them. *National Lead Co.* v. *United States,* 252 U. S. 140. But, in the Act of 1916, Congress added § 13(d), which did not have its counterpart in earlier legislation. This section went further than any previous regulation by authorizing the tax return to be made on the basis on which the taxpayer's books were kept, provided only that the basis was one reflecting income and the return complied with regulations made by the Commissioner.

* * * * *

The appellee's true income for the year 1916 could not have been determined without deducting from its gross income for the year the total cost and expenses attributable to the production of that income during the year. The reserve for munitions taxes set up on its books for 1916 must have been deducted from receivables for munitions sold in that year before the net results of the operations for the year could be ascertained.

> The taxpayer being unable to make its return on a strict receipts and disbursements basis, and not having attempted to do so, could not have complied with § 13(d) and Treasury Decision 2433 by deducting either accruals of interest or expenses alone without the other, or without deducting other reserves made on its books to meet liabilities such as the munitions tax, incurred in the process of creating income.

The petitioner argues that in making its return for 1916 it complied with the express provisions of the instructions on the blank furnished by the Treasury Department, which stated that only those taxes which had actually been paid during the year might be deducted. (R. 80.) But the form of this return was issued under the date of October, 1916, (R. 67) before Treasury Decision 2433, *supra,* was promulgated. It could hardly be contended that the Commissioner was precluded from changing his regulations, because at the time there was extant a form which contained provisions inconsistent with the new regulation. And the instruction as to the deduction of taxes on the form furnished to the petitioner for returning its 1917 income, now in question, correctly provided for the deduction of taxes "paid or accrued," evidently according to the taxpayer's method of accounting. (R. 97–98.) Moreover, nothing in the instructions on the returns for either 1916 or 1917 indicated that in a return made on the cash basis, accounts receivable

and payable should be treated as receipts and disbursements. (See R. 67–98.)

The petitioner contends that it designated its return as made upon the cash receipts and disbursements basis. Even if the petitioner had so stated on the return, that fact would not be controlling. But, in fact, the petitioner, in answer to the question whether its return for 1917 was made on the basis of actual receipts and disbursements, stated, "Yes; except as below indicated"; and further down on the return it explained this answer by saying, "Bills and Accounts Payable & Receivable are treated as receipts and disbursements." (R. 98.) We contend that a return in which bills and accounts payable and receivable are treated as receipts and disbursements is not a return on the cash receipts and disbursements basis, and that the inclusion of these items in the return makes it a return substantially upon the accrual basis. It is clear from the evidence outlined above (*supra,* p. 14) that the return was not in fact made upon a strict cash basis.

III

EVEN IF PETITIONER WAS ENTITLED TO CHANGE ITS RETURN TO ONE ON A STRICTLY CASH BASIS, IT HAS NOT SHOWN WHAT ITS TAX LIABILITY WOULD BE ON SUCH A RETURN, AND HENCE IT CAN NOT RECOVER

The taxpayer has never attempted to file a return strictly upon the cash receipts and disbursements basis, and it has not shown what its tax liability would be on that basis. The petitioner may have

had large cash receipts in 1917 which did not appear as income in its return for that year because it reported its gross income on the basis of accounts receivable. Consequently, even if the Commissioner was not justified in treating the munitions tax for 1916 as he did, the taxpayer has not shown that its tax liability would have been any less if its return had been computed on a strictly cash basis. Because of this circumstance we contend that even if the taxpayer was entitled to have its income computed on the cash basis, it can not succeed, as it has not sustained the burden of showing that the tax collected was in excess of what could legally have been exacted. The burden of establishing all facts essential to the recovery is on the petitioner. *Botany Mills* v. *United States,* 278 U. S. 282; *Reinecke* v. *Spaulding,* 280 U. S. 227.

CONCLUSION

It is respectfully submitted that the judgment of the Circuit Court of Appeals should be affirmed.

THOMAS D. THACHER,
Solicitor General.
G. A. YOUNGQUIST,
Assistant Attorney General.
CLAUDE R. BRANCH,
J. LOUIS MONARCH,
Special Assistants to the Attorney General.
ERWIN N. GRISWOLD,
Attorney.

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APPENDIX A

STATUTES

The Corporation Excise Tax Law of 1909, c. 6, 36 Stat. 11, 112–113, provided:

> SEC. 38. That every corporation * * * shall be subject to pay annually a special excise tax * * * equivalent to 1 per centum upon the entire net income over and above five thousand dollars received by it from all sources * * *.
>
> Second. Such net income shall be ascertained by deducting from the gross amount of the income of such corporation * * * received within the year from all sources, (first) all the ordinary and necessary expenses actually paid within the year * * *; (second) all losses actually sustained within the year, * * * including a reasonable allowance for depreciation of property, if any, * * *; (third) interest actually paid within the year * * *; (fourth) all sums paid by it within the year for taxes * * *.

The corporation income-tax provisions contained in Subdivision G of Section 2 of the Act of October 3, 1913, c. 16, 38 Stat. 114, 172–173, provided:

> G. (a) That the normal tax hereinbefore imposed upon individuals likewise shall be levied, assessed, and paid annually upon the entire net income arising or accruing from all sources during the preceding calendar year to every corporation * * *.

(b) Such net income shall be ascertained by deducting from the gross amount of the income of such corporation * * * received within the year from all sources, (first) all the ordinary and necessary expenses paid within the year * * *; (second) all losses actually sustained within the year * * *, including a reasonable allowance for depreciation by use, wear and tear of property, if any; and in the case of mines a reasonable allowance for depletion of ores and all other natural deposits, * * *; (third) the amount of interest accrued and paid within the year on its indebtedness * * *; (fourth) all sums paid by it within the year for taxes * * *.

The Revenue Act of 1916 (Act of September 8, 1916), c. 463, 39 Stat. 756, 767–771, provided:

TITLE I.—INCOME TAX

* * * * *

PART II.—ON CORPORATIONS

SEC. 10. That there shall be levied, assessed, collected, and paid annually upon the total net income received in the preceding calendar year from all sources by every corporation, joint-stock company or association, or insurance company, organized in the United States, no matter how created or organized but not including partnerships, a tax of two per centum upon such income; * * *.

The foregoing tax rate shall apply to the total net income received by every taxable corporation, joint-stock company or association, or insurance company in the calendar year nineteen hundred and sixteen and in each year thereafter * * *.

* * * * *

SEC. 12. (a) In the case of a corporation * * * such net income shall be ascertained by deducting from the gross amount of its income received within the year from all sources—

First. All the ordinary and necessary expenses paid within the year * * *;

Second. All losses actually sustained and charged off within the year * * *;

Third. The amount of interest paid within the year * * *;

Fourth. Taxes paid within the year * * *.

* * * * *

SEC. 13. * * *.

(d) A corporation * * * keeping accounts upon any basis other than that of actual receipts and disbursements, unless such other basis does not clearly reflect its income, may, subject to regulations made by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, make its return upon the basis upon which its accounts are kept, in which case the tax shall be computed upon its income as so returned;

The Revenue Act of 1917 (Act of October 3, 1917), c. 63, 40 Stat. 300, 302, 303, 305, contained the following provisions:

TITLE II.—WAR EXCESS PROFITS TAX

SEC. 200. That when used in this title—

* * * * *

The term "taxable year" means the twelve months ending December thirty-first, excepting in the case of a corporation or partnership which has fixed its own fiscal year, in which case it means such fiscal year. The first taxable year shall be the year ending December thirty-first, nineteen hundred and seventeen, except that in the case of a

corporation or partnership which has fixed its own fiscal year, it shall be the fiscal year ending during the calendar year nineteen hundred and seventeen. * * *

* * * * *

SEC. 201. That in addition to the taxes under existing law and under this act there shall be levied, assessed, collected, and paid for each taxable year upon the income of every corporation, partnership, or individual, a tax (hereinafter in this title referred to as the tax) equal to the following percentages of the net income:

* * * * *

SEC. 206. That for the purposes of this title the net income of a corporation shall be ascertained and returned * * * (c) for the taxable year upon the same basis and in the same manner as provided in Title I of the Act entitled "An Act to increase the revenue, and for other purposes," approved September eighth, nineteen hundred and sixteen, as amended by this Act, except that the amounts received by it as dividends upon the stock or from the net earnings of other corporations, joint-stock companies or associations, or insurance companies, subject to the tax imposed by Title I of such Act of September eighth, nineteen hundred and sixteen, shall be deducted.

The Revenue Act of 1918, c. 18, 40 Stat. 1057, 1058, contained the following provisions:

SEC. 200. That when used in this title—

* * * * *

The term "paid," for the purposes of the deductions and credits under this title, means "paid or accrued" or "paid or incurred," and the terms "paid or incurred" and "paid or accrued" shall be construed

according to the method of accounting upon the basis of which the net income is computed under section 212.

SEC. 212. * * *.

(b) The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made upon such basis and in such manner as in the opinion of the Commissioner does clearly reflect the income. * * *

SEC. 213. That for the purposes of this title * * * the term "gross income"—

(a) Includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * *, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, * * * or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. The amount of all such items shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under subdivision (b) of section 212, any such amounts are to be properly accounted for as of a different period; * * *.

SEC. 233. (a) That in the case of a corporation * * * the term "gross income" means the gross income as defined in section 213, * * *.

SEC. 234. (a) That in computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:

(1) All the ordinary and necessary expenses paid or incurred during the taxable year * * *;

(2) All interest paid or accrued within the taxable year * * *;

(3) Taxes paid or accrued within the taxable year * * *;

APPENDIX B

TREASURY REGULATIONS AND DECISIONS

REGULATIONS

Regulations 31, promulgated December 3, 1909, under the Act of August 5, 1909, provided:

ARTICLE 2. *Gross Income.*—The following definitions and rules are given for determining the gross income of the various classes of corporations:

* * * * *

3. *Manufacturing companies.*—Gross income received during the year from all sources will consist of the total amount, ascertained through an accounting, that shows the difference between the price received for the goods as sold and the cost of such goods as manufactured. The cost of goods manufactured shall be ascertained by an addition of a charge to the account of the cost of goods as manufactured during the year of the sum of the inventory at beginning of the year and a credit to the account of the sum of the inventory at the end of the year. To this amount should be added all items of income received during the year from other sources, including dividends received on stock of other corporations, joint-stock companies, associations, and insurance companies subject to this tax. In the determination of the cost of goods manufactured and sold as above such cost shall comprehend all charges for

maintenance and operation of manufacturing plant, but shall not embrace allowances for depreciation of property nor for losses sustained which are to be taken account of in ascertaining the net income subject to tax under the proper heading in the authorized deductions.

* * * * *

It will be noted from these definitions that gross income is practically the same as gross profits, the only difference being that gross income is more inclusive, embracing as it does not only gross profits of the corporation, joint-stock company and association itself, but also all amounts of income received from other sources. It is immaterial whether any item of gross income is evidenced by cash receipts during the year or in such other manner as to entitle it to proper entry on the books of the corporation from January 1 to December 31 for the year in which return is made.

* * * * *

ARTICLE 4. *Deductions.*—The specified deductions actually paid within the year, set forth in the statute and as described in article 3 preceding, shall include all proper items of expenses and charges under the respective heads as designated. The amount returned for ordinary and necessary expenses actually paid within the year out of income in maintenance and operation of the business and properties of the corporation should not, however, embrace allowances for depreciation of fixed property which are otherwise to be taken account of under the proper heading in the authorized deductions, nor expenses paid within the year and charged to such allowances for depreciation credited in the current year or in previous

years. In ascertaining expenses proper to be included in the deductions to be made under this article, corporations carrying materials and supplies on hand for use should include in such expenses the charges for materials and supplies only to the amount that the same are actually disbursed and used in operation and maintenance during the year for which the return is made.

It is immaterial whether the deductions are evidenced by actual disbursements in cash, or whether evidenced in such other way as to be properly acknowledged by the corporate officers and so entered on the books as to constitute a liability against the assets of the corporation, joint-stock company association, or insurance company making the return.

* * * * *

ARTICLE 6. * * *

Bookkeeping.—No particular system of bookkeeping or accounting will be required by the Department. However, the business transacted by corporations, joint-stock companies, associations, or insurance companies must be so recorded that each and every item therein set forth may be readily verified by an examination of the books and accounts, where such examination is deemed necessary.

Regulations 33, promulgated January 5, 1914, under the Act of October 3, 1913, provided:

ART. 104. Gross income of manufacturing companies shall consist of the total sales of manufactured goods during the year covered by the return, increased or decreased by the gain or loss as shown by the inventories of finished and unfinished products, raw material, etc., at the beginning and end of the year. To this amount should be added the

income, gains, or profits from all other sources as shown by the books of account.

ART. 148. The amount of interest accrued and paid within the year by a corporation on an amount of bonded or other indebtedness not in excess of *one-half* of the *sum* of the interest-bearing indebtedness *and* the paid-up capital stock outstanding at the close of the year, or, if no capital stock, on the amount of interest-bearing indebtedness not exceeding the amount of capital employed in the business at the close of the year, constitutes an allowable deduction; that is, the maximum principal, upon which interest for the purpose of this deduction, can be computed must not exceed, in the one case, one-half of the sum of the interest-bearing indebtedness and the capital stock outstanding at the close of the year, or, in the other case, must not exceed the amount of capital employed in the business at the close of the year. The interest to be deductible must have been computed on the proper principal at the contract rate and must have been actually paid within the year.

ART. 156. Reserves for taxes can not be allowed, as the law specifically provides that only such sums as are paid within the year for taxes shall be deducted.

ART. 158. It is immaterial whether the deductions except for taxes and losses are evidenced by actual disbursements in cash, or whether evidenced in such other way as to be properly acknowledged by the corporate officers and so entered on the books of the corporation as to constitute a liability against the assets of the corporation making the return. Deductions for taxes, however, should be the aggregate of the amounts actually paid, as shown on the cash book of

the corporation. Deductions for losses should be confined to losses actually sustained and charged off during the year and not compensated by insurance or otherwise. Except as the same may be modified by the provisions of the act, limiting certain deductions and authorizing others, the net income as returned for the purpose of the tax should be the same as that shown by the books or the annual balance sheet.

Regulations 33 (revised), promulgated January 2, 1918, under the provisions of the Revenue Act of 1916, as amended by the Act of October 3, 1917, provided:

> ART. 126. *"Paid" or "actually paid."*— "Paid" or "actually paid," within the meaning of this title, does not necessarily contemplate that there shall be an actual disbursement in cash or its equivalent. If the amount involved represents an actual expense or element of cost in the production of the income of the year, it will be properly deductible even though not actually disbursed in cash, provided it is so entered upon the books of the company as to constitute a liability against its assets, and provided further that the income is also returned upon an accrued basis.
>
> If in the course of its business, a corporation credits the accounts of individuals, firms, or corporations with the amount of any expenses, interest, rentals, wages, etc., due them, thereby making them subject to the personal drawings of such creditors, or if expenses actually incurred are vouchered in definite amounts, the amounts so credited or vouchered may be treated as paid, and if the amounts so credited or vouchered are expenses incurred concurrently with and in

the production of the income of the year, they may be allowably deducted therefrom.

* * * * *

ART. 127. *Approved accounting practices.*—Pursuant to the foregoing provision, corporations keeping their accounts in strict accord with the methods prescribed by municipal, State, or Federal authorities, or in accord with approved standard accounting practices consistently followed from year to year, will be permitted to make their returns of annual net income on the basis of the accounts so kept, provided such systems of accounting clearly and correctly reflect the net income of each year.

Charges against current earnings.—All expenses, including interest, taxes, and other necessary charges, incidental and necessary to the creation or production of the gross income or properly chargeable against the same, being deductible from the gross income, whether paid in cash or entered on the books as a liability, can not, if unpaid, be carried forward to be deducted from the gross income of a subsequent year.

Each year's return complete.—Each year's return, both as to income and deductions therefrom, must be complete within itself. Charges, of whatever character, against income can not be cumulative. They must be deducted from the income of the year in which incurred or not at all. The expenses, liabilities, or deficit of one year can not be used to reduce the income of a subsequent year.

* * * * *

ART. 128. *Previous year's charges not deductible.*—A corporation having the right under this rule to deduct all authorized

allowances, whether paid in cash or set up as a liability, it follows that if it does not within any year pay or accrue certain of its expenses, interest, taxes, or other charges, and makes no deduction therefor, it can not deduct from the income of the next or any subsequent year any amounts then paid in liquidation of the previous year's liabilities.

Amended returns.—If, however, a corporation discovers or detects expenses or liabilities which were due and payable during a preceding year, it will be permissible for it to make an amended return for the year to which such expense or liability applies, include such expense in the deductions of that year, and file a claim for refund for any taxes overpaid by reason of the failure to deduct such expense or liability in the original return of that year.

Any system of accounting which is not consistent with the purpose and intent of the rules set out in this title, and with the general rules set out in these regulations for the ascertainment of net income, will not be accepted as a correct basis for making returns.

* * * * *

ART. 180. * * *

Paid or charged as a liability.—The amount of interest thus computed at the contract rate, if actually paid within the year, may be deducted, or if the accounts of the company are kept on a basis other than actual receipts and disbursements, the amount of interest actually accrued at the contract rate, if computed on an amount not in excess of the maximum principal as hereinbefore indicated, may be deducted, provided it is so entered upon the books as to constitute a liability against the assets, and provided it does not include interest on in-

debtedness incurred in the purchase of securities, the income from which is not subject to the income tax.

TREASURY DECISION 2367

Treasury Department,
Office of Commissioner
of Internal Revenue,
Washington, D. C., September 14, 1916.

To collectors of internal revenue:

Pending the adoption and promulgation of special regulations under the act of September 8, 1916, income-tax regulations in force September 8, 1916, are hereby extended and made applicable to the act of September 8, 1916, so far as not inconsistent with the provisions of that statute.

W. H. OSBORN,
Commissioner of Internal Revenue.

Approved:

BYRON R. NEWTON,
Acting Secretary of the Treasury.

TREASURY DECISION 2433

Treasury Department,
Office of Commissioner
of Internal Revenue,
Washington, D. C., January 8, 1917.

To collectors of internal revenue:

Subparagraph (d) of section 13 of Title I of the act of September 8, 1916, provides that—

> A corporation, joint-stock company or association, or insurance company, keeping accounts upon any basis other than that of actual receipts and disbursements, unless

> such other basis does not clearly reflect its income, may, subject to regulations made by the Commissioner of Internal Revenue with the approval of the Secretary of the Treasury, make its returns upon the basis upon which its accounts are kept, in which case the tax shall be computed upon its income as so returned.

Under this provision it will be permissible for corporations which accrue on their books monthly or at other stated periods amounts sufficient to meet fixed annual or other charges to deduct from their gross income the amounts so accrued, provided such accruals approximate as nearly as possible the actual liabilities for which the accruals are made, and provided that in cases wherein deductions are made on the accrual basis as hereinbefore indicated income from fixed and determinable sources accruing to the corporations must be returned, for the purpose of the tax on the same basis.

In cases wherein, pursuant to the consistent practice of accounting of the corporation, or pursuant to the requirements of some Federal, State, or municipal supervising authority, corporations set up and maintain reserves to meet liabilities, the amount of which and the date of payment or maturity of which is not definitely determined or determinable at the time the liability is incurred, it will be permissible for the corporations to deduct from their gross income the amounts credited to such reserves each year, provided that the amounts deductible on account of the reserves shall approximate as nearly as can be determined the actual amounts which experience has demonstrated would be necessary to discharge the liabilities incurred

during the year and for the payment of which additions to the reserves were made; and provided, if it shall be found that the amount credited to any such reserve is in excess of the reasonable or probable needs of the corporation to meet and discharge the liabilities for which the reserve is credited, the excess of such reserve over and above the reasonable or probable needs for the purpose indicated shall be at once disallowed as a deduction and restored to income for the purpose of the tax; and provided further, that in no event will sinking funds or other reserves set up to meet additions, betterments, or other capital obligations constitute allowable deductions from gross income.

This ruling contemplates that the income and authorized deductions shall be computed and accounted for on the same basis and that the same practice shall be consistently followed year after year. Amounts paid in discharge of any liability or obligation for which a reserve has been set up, as hereinbefore outlined, will, when paid, be charged to the reserve created to meet it, in so far as such reserve is sufficient to meet the liability, provided always that the liability is of a character which constitutes an allowable deduction within the meaning of the law.

If upon investigation it shall be found that returns made upon the basis of accruals and reserves do not reflect the true net income, the corporation so failing in this way to return the true net income will not thereafter be permitted to make its returns upon any basis other than that of actual receipts and disbursements.

The reserves contemplated by the foregoing ruling are those reserves only which are set up to meet

some actual liability incurred, the amount necessary to discharge which can not at the time be definitely determined, and do not contemplate reserves to meet losses contingent upon shrinkage in values, losses from bad debts, capital investments, etc., which losses are deductible only when definitely determined as the result of a closed or completed transaction and are charged off.

W. H. OSBORN,
Commissioner of Internal Revenue.

Approved:

W. G. MCADOO,
Secretary of the Treasury.

APPENDIX C

Reports of Congressional Committees

REVENUE ACT OF 1916

Report of the Committee on Ways & Means to the House (House Report No. 922, 64th Congress, 1st Session, p. 4):

> The present law requires that the income tax shall be levied on the accrued basis. As two systems of bookkeeping are in use in the United States, one based on the cash or receipt basis and the other on the accrual basis, it was deemed advisable to provide in the proposed measure that an individual or corporation may make return of income on either the cash or accrued basis, if the basis selected clearly reflects the income.

REVENUE ACT OF 1918

Report of the Committee of Conference to the House (House Report No. 1037, 65th Congress, 3rd Session, pp. 3, 44):

> Amendment numbered 13: That the House recede from its disagreement to the amendment of the Senate numbered 13, and agree to the same with an amendment as follows:

In lieu of the matter inserted by said amendment insert the following:

> *The term "paid," for the purposes of the deductions and credits under this title,*

means "paid or accrued" or "paid or incurred," and the terms "paid or incurred" and "paid or accrued" shall be construed according to the method of accounting upon the basis of which the net income is computed under section 212.

And the Senate agreed to the same.

* * * * * *

Amendment No. 13: This amendment provides that the terms "paid or incurred" and "paid or accrued" when used in the income-tax title shall be construed according to the method of accounting upon the basis of which the net income is computed under section 212; and the House recedes with an amendment defining the word "paid" when used for the purpose of computing the deductions and credits.

U. S. GOVERNMENT PRINTING OFFICE 1930

CORRECTED COPY

SUPREME COURT OF THE UNITED STATES.

No. 7—October Term, 1930.

The Aluminum Castings Company, Petitioner, *vs.* Carl F. Routzahn, Individually and as Collector of Internal Revenue.	On Writ of Certiorari to the United States Circuit Court of Appeals for the Sixth Circuit.

[November 24, 1930.]

Mr. Justice Stone delivered the opinion of the Court.

Petitioner, a manufacturer of metal castings, brought suit in the District Court for Northern Ohio to recover income and excess profits taxes assessed and paid for the calendar year 1917. Right to recover was asserted on the sole ground that a munitions tax levied under Title III of the Revenue Act of 1916, c. 463, 39 Stat. 756, 780, which became due and was paid by petitioner in 1917, was correctly deducted from gross income in petitioner's tax return for that year. The Commissioner, rejecting this contention, deducted the tax from gross income for 1916, the year when it accrued, see *United States* v. *Anderson*, 269 U. S. 422, and collected a correspondingly increased income and profits tax for 1917, which is involved in the present suit.

The District Court, finding that petitioner kept its books and filed its tax returns for 1916 and 1917 on the "accrual basis", gave judgment for the ~~government~~ collector, 24 F. (2d) 230, which the Court of Appeals for the Sixth Circuit affirmed, 31 F. (2d) 669. Both courts held, on the authority of *United States* v. *Anderson, supra,* that as the books were kept and returns made on the accrual basis, the munitions tax which accrued in 1916 could not be deducted in the return for 1917.

Petitioner's returns for 1916 and 1917 were made after the effective date of §§ 12 (a), 13 (b) and 13 (d) of the Revenue Act of 1916 (c. 463, 39 Stat. 767, 771). The Act imposes a tax

on net income and profits ascertained, as provided by § 12 (a), by deducting from gross income expenses, interest and taxes paid, and losses sustained, during the calendar year. Section 13 (d) provides that "A corporation . . . keeping accounts upon any basis other than that of actual receipts and disbursements, unless such other basis does not clearly reflect its income, may, subject to regulations made by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, make its return upon the basis upon which its accounts are kept, in which case the tax shall be computed upon its income as so returned."

Petitioner, in response to an inquiry on the form for the 1916 return, stated that it was "made on the basis of actual receipts and disbursements", a statement which it repeated in the 1917 return with the qualification that "Bills and accounts payable and receivable are treated as receipts and disbursements". In both returns, bills and accounts, payable and receivable, in fact were treated as actual receipts and disbursements; and both were based on inventories taken at the beginning and end of the taxable year. The munitions tax deducted in the 1917 return first appeared on the taxpayer's books in that year.

Petitioner contends that its returns were made as "cash receipts and disbursements" returns under § 12 (a) and not under § 13 (d), and that since by § 12 (a) taxes are required to be deducted only in the year when paid, its munitions tax was rightly deducted in the 1917 return. In support of this contention, it is pointed out that § 12 (a) of the 1916 Act does not differ materially from corresponding provisions of the Revenue Acts of 1909 and 1913 (Corporation Excise Tax Act of Aug. 5, 1909, c. 6, § 38, 36 Stat. 11, 112; Corporation Income Tax Act of Oct. 3, 1913, c. 16, § II., subdiv. G, 38 Stat. 114, 172), and as petitioner's returns for 1916 and 1917 would have been authorized under these earlier acts, and Treasury Regulations supplementing them, it is argued that petitioner's right to deduct taxes when paid was not altered by the addition to the revenue laws, in the 1916 Act, of § 13 (d), which merely gave to the taxpayer an option, not availed of by petitioner, to make a return on the accrual basis.

This argument is, in substance, that considered and rejected by the Court in *United States* v. *Anderson, supra,* p. 439. There, as here, the taxpayer's return for 1917 computed income on the basis

of inventories and accrued items, payable and receivable, appearing on the taxpayer's books of account for that year, but deducted from gross income the munitions tax, paid in 1917, which had accrued the year before. The return, as made, would have been permissible under the Revenue Acts preceding that of 1916; but it was held that under that Act the tax was required to be deducted in the year when it accrued.

Section 12 (a) of the 1916 Act, like its prototypes in the earlier legislation, deals only with the deduction from gross income of amounts paid out or losses sustained. None of them, in terms, permitted the deduction of accounts payable or made any provision for the use of inventories in computing net income. Experience demonstrating that income derived from merchandising and manufacturing businesses could not be computed on the basis of receipts and disbursements alone, treasury regulations were promulgated requiring the use of inventories in proper cases, and permitting the deduction of accounts payable when accounts receivable were brought into the income account. Treasury Regulations 31, Dec. 3, 1909, under the Act of Aug. 5, 1909; 33, Jan. 5, 1914, under the Act of Oct. 3, 1913.

But this action of the Department, born of necessity in order to arrive at the income of certain businesses, was neither a classification nor an irrevocable designation of items receivable and payable as cash receipts and disbursements. Although the regulations supplemented the provisions of the statute by providing for a different method of computing income, they did not alter the meaning of its words, or preclude acceptance of them at their face value when reenacted in a new legislative setting. Classification took place when § 13 (d) was substituted for existing treasury regulations,[1] and broadly authorized returns under it by taxpayers "keeping accounts upon any basis other than that of actual receipts and disbursements", a phrase which, in the light of the legislative history, plainly indicates that the returns contemplated by § 13 (d) were to

[1]Pending the adoption of regulations applicable to the Act of 1916, Treasury Decision 2367, Sept. 14, 1916, continued existing regulations in force only so far as not inconsistent with the provisions of the 1916 Act. New regulations applicable to §§ 12 (a) and 13 (d), adopted in Treasury Decision 2433, Jan. 8, 1917, before petitioner filed its 1916 and 1917 returns, are considered infra, p. 4.

be dealt with as a separate class, distinct from those based on actual receipts and disbursements alone described by § 12 (a)[2].

By these sections the filing of a return under § 13 (d), where the taxpayer is able to comply with its requirements, is optional if he is also able to prepare a return on the basis of actual receipts and disbursements which reflects true income. But "notwithstanding the option given taxpayers, it is the purpose of the Act to require returns that clearly reflect taxable income." *United States* v. *Mitchell,* 271 U. S. 9, 12. By § 13 (b) of the 1916 Act, which was new, the return in every case is required to state such data as are "appropriate and in the opinion of the commissioner necessary to determine the correctness of the net income returned and to carry out the provisions of this title." It follows that the return must be filed on the accrual basis under § 13 (d), where true income cannot be arrived at on the basis of actual receipts and disbursements. See *United States* v. *Anderson, supra,* pp. 437, 440. Any other construction of §§ 12 (a) and 13 (d) would disregard the requirement of § 13 (b) and the dominating purpose of the Act, by enabling the taxpayer to file a return which did not reflect true income. See *United States* v. *Mitchell, supra,* pp. 12, 13. It was in recognition of this, and in compliance with § 13 (b), that Treasury Decision 2433, Jan. 8, 1917, provided with respect to returns made under §§ 12 (a) and 13 (d):

"This ruling contemplates that the income and authorized deductions shall be computed and accounted for on the same basis and that the same practice shall be consistently followed year after year."

This ruling antedated petitioner's 1916 and 1917 returns, and obviously gross income and deductions in its returns were not "accounted for on the same basis". Its income for 1917 could not be ascertained by deducting from gross income, including receivables, some items of cost and expense, attributable to the pro-

[2]The Report of the Committee on Ways and Means (House Report No. 922, 64th Cong., 1st Sess., p. 4) states with reference to the income tax provisions of the Revenue Act of 1916:

"As two systems of bookkeeping are in use in the United States, one based on the cash or receipt basis and the other on the accrual basis, it was deemed advisable to provide in the proposed measure that an individual or corporation may make return of income on either the cash or accrued basis, if the basis selected clearly reflects the income."

duction of 1917 income, which accrued but were not paid in that year, and the munitions tax, which was paid in 1917, but which accrued and was attributable to the production of income in 1916.

Petitioner, relying on the declarations in its returns that they were made on the basis of actual receipts and disbursements, contends that for that reason they must be deemed made under § 12 (a) and not under § 13 (d). But whether a return is made on the accrual basis, or on that of actual receipts and disbursements, is not determined by the label which the taxpayer chooses to place upon it. The use of inventories, and the inclusion in the returns of accrual items of receipts and disbursements appearing on petitioner's books, indicate the general and controlling character of the account, *Niles Bement Pond Co.* v. *United States,* 281 U. S. 357, 360; *United States* v. *Anderson, supra,* pp. 442, 443, and support the finding of the trial court that books and returns were on the accrual basis. The record does not disclose that petitioner offered to make a return for 1917 on the basis of actual receipts and disbursements, or that it could have done so. It was, therefore, competent for the Commissioner to correct the return for 1917, to conform it to the system of accounting in fact adopted, by excluding from it the munitions tax which had accrued in 1916, whether appearing on the books for that year or not. *United States* v. *American Can Co.,* 280 U. S. 412; *United States* v. *Anderson, supra*; *Niles Bement Pond Co.* v. *United States, supra.*

Affirmed.

A true copy.

Test:

Clerk, Supreme Court, U. S.

SUPREME COURT OF THE UNITED STATES.

No. 7—October Term, 1930.

The Aluminum Castings Company, Petitioner, *vs.* Carl F. Routzahn, Individually and as Collector of Internal Revenue.	On Writ of Certiorari to the United States Circuit Court of Appeals for the Sixth Circuit.

[November 24, 1930.]

The separate opinion of Mr. Justice McReynolds and Mr. Justice Butler.

In our view the decree below should be reversed. This Court has often affirmed: "In the interpretation of statutes levying taxes it is the established rule not to extend their provisions, by implication, beyond the clear import of the language used, or to enlarge their operations so as to embrace matters not specifically pointed out. In case of doubt they are construed most strongly against the Government, and in favor of the citizen." *Gould* v. *Gould*, 245 U. S. 151, 153. *Crocker* v. *Malley*, 249 U. S. 223, 233; *United States* v. *Field*, 255 U. S. 257, 262; *Smietanka* v. *First Trust & Savings Bank*, 257 U. S. 602, 606; *Shwab* v. *Doyle*, 258 U. S. 529, 534; *United States* v. *Merriam*, 263 U. S. 179, 188; *Hecht* v. *Malley*, 265 U. S. 144, 156; *Reinecke* v. *Northern Trust Co.*, 278 U. S. 339, 348.

We think it impossible properly to say that the statute under consideration, by clear import, laid the questioned tax. The petitioner made its return after the mode long approved by the Treasury Department and distinctly disavowed any purpose to accept the option granted by section 13 (d). Under an interpretation, certainly not free from grave doubt, a taxpayer who honestly sought to do what capable counsel well might have advised has been heavily burdened.

United States v. *Anderson*, 269 U. S. 422, differs materially from the present cause upon the facts and, we think, is not enough to support the conclusion of the court below.

SUPREME COURT OF THE UNITED STATES.

No. 7.—October Term, 1930.

The Aluminum Castings Company, Petitioner, *vs.* Carl F. Routzahn, Individually and as Collector of Internal Revenue.	On Writ of Certiorari to the United States Circuit Court of Appeals for the Sixth Circuit.

[November 24, 1930.]

Mr. Justice Sutherland, concurring.

I did not agree with the decision in the *Anderson* case, but so long as the majority of the court adheres to it, I am bound to follow it in similar cases; and in principle, I think, it controls here. It is true that there are differences in matters of fact between the present case and that case, but they seem to me not to be of a character to affect the pertinence of the *Anderson* decision and call for the application of a different rule. For that reason alone I concur in the opinion of the court just announced. Were it not for the *Anderson* case I should join in the dissent.

Mr. Justice Roberts concurs in this view.